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Supreme Court, U. S
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No.

COY L. WEAVER AND HELEN F. WEAVER, *Petitioners*

v.

RICHARD M. HUTSON, II., TRUSTEE OF LANDMARK INNS OF DURHAM, INC., *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

CHARLES B. NYE
Nye & Mitchell
Attorneys at Law
P. O. Box 1131
Durham, North Carolina 27702
Attorney for Petitioners

SUBJECT INDEX

Page

PETITION

Citations to Opinions Below 1
Jurisdiction 2
Question Presented 2
Statutes Involved 2
Statement of the Case 2
Reasons for Granting the Writ 7
Conclusion 14

CITATIONS

CASES:

B.J.M. Realty Corporation v. Ruggieri, 2nd Cir., 326 F. 2d 281 (1964) 9, 10
Brinkley et al v. Smithwick, 126 F. 686 (E.D.N.C.) ... 13
Carson v. Imperial '400' National, Inc., 267 N.C. 229, 147 S.E. 2d 898 (1966) 11
City of Alexandria, Louisiana v. Chicago, Rock Island and Pacific R.R., 5th Cir., 321 F. 2d 822, 23 (1963) 8
Empress Theatre Co. v. Horton, 8th Cir., 266 Fed. 657 (1920) 10
Finn v. Meighan, 325 U.S. 300 (1945) 2, 7, 8, 11, 14
Friendly Center, Inc., v. Robinson, 233 F. Supp. 274 (W.D.N.C. 1964) 12
In Re Baum & Rubin, 5th Cir., 29 F. 2d 346 (1928) 10
In Re Fleetwood Motel Corp., 3rd Cir., 335 F. 2d 857 (1964) 6, 9
In Re Frazin, 2nd Cir., 183 Fed. 28 (1910) 10
In Re Hudson & Manhattan Railroad Company, 2nd Cir., 229 F. 2d 616, certiorari denied, 351 U.S. 982 (1956) 13

Page

In Re Lindy-Friedman Clothing Co., 5th Cir., 285 Fed. 22 (1922) 10
In Re Little & Ives Co., 362 F. Supp. 719 (S.D.N.Y. 1966) 10
In Re Michigan Motor Specialties Co., 288 Fed. 377 (E.D. Mich. 1923) 10
In Re Technical Marine Maintenance Co., Inc., 3rd Cir., 169 F. 2d 548 (1948) 14
In Re Walker, 2nd Cir., 93 F. 2d 281 (1937) 10
Lichman v. Moore, 131 F. Supp. 434 (D.N.H. 1955) .. 10
Robinson v. Hadley, 9th Cir., 351 F. 2d 385 (1965) 10
Smith v. Hoboken Railroad Co., 328 U.S. 123 (1946) 7, 8, 11
Speare v. Consolidated Assets Corp., 2nd Cir., 360 F. 2d 882, 87 (1966) 10
Urban Properties Corp. v. Benson, 9th Cir., 116 F. 2d 321 (1940) 10

MISCELLANEOUS:

9 Am. Jur. 2d, Bankruptcy § 1568 11
49 Am. Jur. 2d, Landlord and Tenant, § 028 8
Bankr. Act, July 1, 1968, c. 541 § 3, subsec. 5, 30 Stat. 546 [U. S. Comp. St. 1901, p. 3422] 13
Collier on Bankruptcy, Volume 1, p. 209 (14th Ed.) (1962) 11
11 U.S.C.A. § 110 (b) 2
United States Code, Title 28, Section 1254 (1) 2

APPENDICES:

Appendix A, Findings of Fact, Conclusions of Law, and Order, of the Bankruptcy Court for the Middle District of North Carolina, dated July 31, 1970 .... 1a
Appendix B, Order of the United States District Court for the Middle District of North Carolina, entered by the Honorable Eugene A. Gordon, dated March 4, 1971 ..... 32a

Page

Appendix C, Order of the United States District Court for the Middle District of North Carolina, entered by the Honorable Eugene A. Gordon, dated March 16, 1971 ..... 33a

Appendix D, Original Opinion of the Fourth Circuit Court of Appeals dated February 28, 1972 ..... 34a

Appendix E, Petition for Rehearing in the Fourth Circuit Court of Appeals, dated March 10, 1972 ..... 40a

Appendix F, Order of the Fourth Circuit Court of Appeals, dated March 31, 1972 ..... 46a

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioners, Coy L. Weaver and Helen F. Weaver, respectfully request that a Writ of Certiorari be issued to review the opinion of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled cause on February 28, 1972.

CITATIONS TO OPINIONS BELOW

The Findings of Fact, Conclusions of Law, and Order of the Referee in Bankruptcy is unreported, but is set forth in the Appendix (A p 1a); the Orders of the District Court are unreported, but are set forth in the Appendix (A pp 32a, 33a); that the opinion of the Fourth Circuit Court of Appeals is reported in Vol. —, Page —, of the Federal

Reporter, 2d Series (1972); that in apt time, a Petition for Rehearing was filed with the Circuit Court of Appeals (A p 40a) and was denied on March 31, 1972 (A p 46a).

JURISDICTION

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1).

The Petitioners seek the review of the United States Court of Appeals' decision which was entered and filed on February 28, 1972 (A p 34a) and of the Order Denying Petitioners' Petition for Rehearing which was made and entered on March 31, 1972 (A p 46a), both being rendered and filed without notation as to time of entry.

QUESTION PRESENTED

1. Has the Bankruptcy rule been changed since *Finn* v. *Meighan*, 325 U.S. 300 (1945) so as to give Bankruptcy Courts in every Chapter X proceedings the power and discretion to refuse enforcement of Section 70 (b) of the Bankruptcy Act, 11 U.S.C.A. 110 (b), which provides that "... an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable."

STATUTES INVOLVED

This case involves the interpretation and enforcement of Section 70 (b) of the Bankruptcy Act, 11 U.S.C.A. 110 (b), and in particular, that portion which states that "... an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable."

STATEMENT OF THE CASE

On March 27, 1964, the Petitioners (Landlords) leased their sole real property asset to the Debtor's predecessor in title for a term of fifty-two (52) years, and the Debtor

subsequently took over the lease subject to all of the terms and provisions thereof. At the inception of the agreement, the Debtor had no assets other than the leased premises and the Debtor corporation was owned by approximately four (4) promoters who anticipated building a motel on the premises financed entirely through the subordination of the leasehold premises; however, of the initial estimated construction cost of Nine Hundred Twenty-Five Thousand & 00/100 ($925,000.00) Dollars, only Seven Hundred Thirty Thousand & 00/100 ($730,000.00) Dollars could be obtained through the first mortgage made possible by the Landlords' subordination of their reversion. The final cost of the leasehold improvements amounted to One Million One Hundred Seventy-Five Thousand Four Hundred Ninety-Six & 56/100 ($1,175,496.56) Dollars, and the Landlords further subordinated their reversion by a second mortgage in the sum of One Hundred Ten Thousand & 00/100 ($110,000.00) Dollars, thereby furnishing unto the Debtor over seventy percent (70%) of the funds necessary to pay for the total leasehold improvements.

The lease provided for a stipulated sum to be paid to the Landlords each year plus a certain percentage of the gross income, and further provided specifically in Paragraph 12, as follows:

> "This Lease shall be terminated by any act of the Tenant, the result of which would be to pass by operation of law, or otherwise, any interest or estate in the leased premises to any Trustee or Receiver in bankruptcy, or any receiver or assignee for the benefit of creditors of the Tenant, or to a purchaser at a sheriff's sale or court sale, or to any other similar party, and all estate hereby leased shall thereupon revert to the Landlord without notice to the Tenant and without further conveyance, including all assets, personal property, and improvements of the Tenant then on the premises; and it is understood and agreed by the Landlord and Tenant that this Lease shall not be or constitute an asset if in the event a receivership or assignment for the benefit of creditors is made or the said Tenant shall be de-

> clared a bankrupt, and the Landlord shall be declared a preferred creditor in all respects, particularly as to any unpaid or future unpaid rents as provided for in this Lease."

Due to the increased costs incurred by the promoters (major shareholders), the Debtor and its promoters sold stock and debentures primarily in the local area and primarily to the Duke Medical Center personnel, and the Referee found that the invested public consisted of eighty-four (84) shareholders and seventy-seven (77) debentureholders. There is, however, a substantial overlap between these two groups. The major shareholders obtained most or all of their stock for services rendered or for their promotion. At no time did the Debtor or its promoters attempt to register the stock or the debentures in accordance with the laws of the State of North Carolina or in accordance with the rules of the Securities and Exchange Commission, and although the Securities and Exchange Commission has intervened in this action, no shareholder or debentureholder has ever complained to it.

Prior to August 15, 1969, the Landlords had made numerous complaints of the Debtor because of the Debtor's breaching numerous provisions of the Lease Agreement, and when the Debtor continued to ignore its breaches and the warnings, the Landlords, on August 15, 1969, declared the lease in default and demanded possession of the premises. Ten (10) days thereafter, the Landlords commenced proceedings in the appropriate State Court for summary ejectment as a result of the Debtor's refusal to comply with its contract provisions or to vacate the premises, and the hearing was scheduled to be heard on September 3, 1969. After the commencement of the hearing in the State Court on September 3, 1969, it was brought to the attention of the Court that three (3) "creditors" (part of the major shareholders group) had, on September 2, 1969, demanded pastdue interest on debenture held by them, and that simultaneous with the start of the State Court trial, the three (3) had filed a Chapter X Petition in the United States

District Court for the Middle District of North Carolina as creditors by virtue of their debenture holdings.

The major shareholders had managed and mismanaged the Debtor from start to finish, and one of the petitioning creditors was the President of the Debtor. The President of the Debtor testified specifically in this bankruptcy proceedings that the actions concerning the demand for interest on the debentures, which was the basis of the "Creditors'" Petition, was a decision made by the Board of Directors of the Debtor. The demand for the pastdue interest on the debentures was made in writing and signed by an Attorney at Law as Attorney in Fact for the three (3) "creditors." The same Attorney at Law signed the Petition as Attorney in Fact for the petitioning "creditors." One of the other two petitioning "creditors," Mr. Livingston, an original promoter, testified in the bankruptcy proceedings that he had, in fact, never demanded interest on the debentures, and when specifically asked whether or not he would have been paid if he had demanded same, stated: "I can't anticipate it because I wouldn't have asked . . . it never entered my head."

Subsequent to the filing of the three (3) "Creditors'" Petition, the Debtor filed a verified Answer in which it admitted, or in which it did not materially controvert, any allegation of the Petition. The "Creditors'" Petition, in addition to alleging that it could not pay its indebtednesses as they accrued, further specifically alleged that:

> ". . . That the said motel operation is conducted on leasehold premises under a long term lease and the landlord has instituted summary ejectment proceedings in the District Court of Durham County, as alleged in Paragraph 4 (d), which proceeding will enforce a landlord's lien against substantially all of the property of the debtor and will eliminate all interests of the stockholders and all unsecured creditors, to their great detriment."

Based upon the verified Answer filed by the Debtor, the Honorable Edwin M. Stanley, Judge of the United States

District Court, entered an Order approving the Petition and appointing a Trustee on the 12th day of September, 1969, in which he found specifically that the Answer filed by the Debtor did not materially controvert any allegation of the Petition.

After the Order Approving the Petition, the Landlords then petitioned the Bankruptcy Court to declare the lease forfeited because of the numerous breaches alleged in the State action and because of the institution of the bankruptcy proceedings. The attorney for the Landlords now admits that it was erroneous to allege all of the breaches and that he should have confined his position to only the breach arising out of the institution of the bankruptcy proceedings, because he is now convinced that a court of equity could have waived or refused to enforce the other breaches, but he is just as convinced that the Bankruptcy Court cannot waive breach pertaining to the institution of the Chapter X proceedings.

Following the hearing in the Bankruptcy Court, the Referee made voluminous Findings of Fact and Conclusions of Law (A p 1a), and specifically held, in Paragraph 41 of his decision (A p 29a), that the present case was on "all fours" with *In Re Fleetwood Motel Corp.*, 3rd Cir., 335 F. 2d 857 (1964), which gave the Bankruptcy Court the discretion and power to refuse enforcement of Paragaph 12 of the lease.

The Landlords timely appealed from the Referee's Findings and Order denying forfeiture, but the Referee's Order was summarily affirmed by the Honorable Eugene A. Gordon (A pp 31a, 33a).

In apt time, the Landlords appealed to the United States Court of Appeals for the Fourth Circuit, and there the Order of the District Court refusing Landlords' Petition for Forfeiture was affirmed by a *per curiam* decision decided and filed on the 28th day of February, 1972 (A p 34a). In apt time, the Landlords filed their Petition for Rehearing with the Fourth Circuit setting out in detail stipulations entered into by and between the Landlords and the Trustee wherein it was specifically stipulated that the acceptance of rents

from the Trustee by the Landlords would be without prejudice to their case (A p 40a). On March 31, 1972, the United States Court of Appeals entered an Order denying the Landlords' Petition for Rehearing; however, the Circuit Court met the issue head-on for the first time in this action. It stated, in its Order Denying Petition for Rehearing, that:

> ". . . The conclusion generally was that as a court of equity the bankruptcy court had the discretion and power to refuse enforcement of Paragraph 12, and rightfully exercised this prerogative. Fleetwood Motel Corporation, 335 F2d 857, 862 (3 Cir. 1964) cited in the opinion in the instant case. Furthermore, we declined forfeiture in the circumstances as defeating the reorganization aims of Chapter X."

The Landlords did nothing to waive their rights under the provisions of Paragraph 12 concerning forfeiture of the lease after the institution of the Chapter X proceedings.

REASONS FOR GRANTING THE WRIT

The Courts below, the Securities and Exchange Commission, the Trustee, and the Debtor attempt to say that this Chapter X proceedings is governed by the rationale or reasoning of *Smith* v. *Hoboken Railroad Co.*, 328 U.S. 123 (1946), while conceding that the *Smith* case does not overrule *Finn* v. *Meighan*, 325 U.S. 300 (1945). In fact, the Landlords say that the *Smith* case reaffirms the *Finn* case on Page 128, as follows:

> ". . . Sec. 70 (b) is applicable to reorganizations under Ch. X as we held in *Finn v. Meighan, supra.* As we pointed out in that case, an express covenant of forfeiture has long been held to be enforceable against the bankruptcy trustee. That represents the bankruptcy rule. . ."

The only reason that the Supreme Court did not allow the forfeiture of the lease in the *Smith* case is adequately and fully explained in the footnote on Page 133, which reads as follows:

"[5] *Finn v. Meighan, supra,* involved the forfeiture of a lease in reorganization proceedings under Ch. X. But the problem there was not complicated by any provisions of Ch. X giving to an administrative agency the functions entrusted to the Interstate Commerce Commission under § 77. As we stated in *Palmer v. Massachusetts,* 308 U.S. 79, 87, '. . . the whole scheme of § 77 leaves no doubt that Congress did not mean to grant to the district courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estates.' "

In *Smith* v. *Hoboken Railroad Co., supra,* the Supreme Court, itself, clearly deferentiates between "public interest" and "private shareholders," 328 U.S. at 123. Also see *City of Alexandria, Louisiana* v. *Chicago, Rock Island and Pacific R.R.,* 5th Cir., 321 F. 2d 822, 23 (1963). Furthermore, the Supreme Court, in the *Smith* case, expressly limited its decision to the particular facts and issues of that case, citing *Finn* v. *Meighan* as the controlling authority for forfeiture when the "public interest," as represented by the Interstate Commerce Commission, is not involved. The Debtor in this case would have the Court interpret the "public interest," as referred to by the Supreme Court in *Smith* v. *Hoboken Railroad Co., supra,* as equivocal to "private shareholders' interest"—which, of course, it is not. The distinction in these terms is why the role of the Securities and Exchange Commission is not the same under the Bankruptcy Act as that of the Interstate Commerce Commission. Because of the public interest involved in a railroad reorganization, the Interstate Commerce Commission, by statute, must give its required approval to any plan of reorganization before the plan can become effective. The Securities and Exchange Commission has no such authority and its role is limited merely to that of "advisory," insuring that the formulated plan of reorganization would not be in fraud or detrimental to the affected shareholders' interest. Of course, this issue is not before the Court.

Additionally, 49 Am. Jur., 2d, *Landlord and Tenant,* § 028, uses the *Smith* case as authority in stating that a

provision of the lease authorizing its termination by the lessor in the event of insolvency, bankruptcy or receivership of the lessee, is valid and enforceable. There is no fact or law which can make the reasoning of the *Smith* case applicable to this case. As plainly admitted by the Securities and Exchange Commission in its brief below, *Smith* arose under Section 77 of the Bankruptcy Act, which provides for the reorganization of railroad companies. A railroad company is a public utility—the Statler-Hilton was the private domain of the mismanaging "majority shareholders" group.

The *Fleetwood* case stated that:

> "The applicability of this section to reorganization proceedings under Chapter X making a covenant like the one in the case at bar enforceable in such proceedings was conclusively established by the Supreme Court in *Finn v. Meighan*, 325 U.S. 300, 65 S. Ct. 1147, 89 L. Ed. 1624 (1965). . . . But less than one year following its decisions in *Finn*, the Court made it clear that the question of the enforceability of such a covenant is separate and distinct from the question of whether enforcement in a particular case would be consistent with other provisions of the Bankruptcy Act."

What other provisions of the Bankruptcy Act are involved in the Landmark Inns of Durham, Inc., proceedings? None!

It is obvious that the Third Circuit and the Fourth Circuit have now decided the Federal question concerning the enforceability of Section 70 (b) of the Bankruptcy Act in conflict with the applicable decisions of the Supreme Court of the United States.

It is just as obvious that the Third and Fourth Circuits are now in conflict with the decisions of all of the other Circuit Courts of Appeal concerning the interpretation and enforceability of Section 70 (b) of the Bankruptcy Act. For example, see *B.J.M. Realty Corporation* v. *Ruggieri*, 2d Cir., 326 F. 2d 281 (1964), wherein the Circuit Court fol-

lowed the teachings of the United States Supreme Court when it stated that:

> "As a general rule, courts do not look kindly on lease forfeiture for filing a bankruptcy petition, but such forfeitures are nonetheless valid and enforceable. *Finn v. Meighan,* 325 U.S. 300, 301, 65 S. Ct. 1147, 89 L. Ed. 1624 (1945); *Model Dairy Co. v. Foltis-Fischer, Inc.,* 67 F. 2d 704, 706 (2 Cir. 1933)."

For opinions of other Circuits which are now in direct conflict with the decisions of the Third and Fourth Circuits and which apparently conform with the bankruptcy rules as interpreted by the Supreme Court of the United States, see: *Robinson* v. *Hadley,* 9th Cir., 351 F. 2d 385 (1965); *Urban Properties Corp.* v. *Benson,* 9th Cir., 116 F. 2d 321 (1940); *Speare* v. *Consolidated Assets Corp.,* 2nd Cir., 360 F. 2d 882, 87 (1966) (although a waiver by landlord found); *In Re Walker,* 2nd Cir., 93 F. 2d 281 (1937); *In Re Frazin,* 2nd Cir., 183 Fed. 28 (1910); *Empress Theatre Co.* v. *Horton,* 8th Cir., 266 Fed. 657 (1920); *In Re Baum & Rubin,* 5th Cir., 29 F. 2d 346 (1928); *In Re Lindy-Friedman Clothing Co.,* 5th Cir., 285 Fed. 22 (1922); *In Re Little & Ives Co.,* 362 F. Supp. 719 (S.D.N.Y. 1966); *Lichman* v. *Moore,* 131 F. Supp. 434 (D.N.H. 1955); and *In Re Michigan Motor Specialties Co.,* 288 Fed. 377 (E.D. Mich. 1923).

The Petitioners admit that if forfeiture is not allowed, that the bankrupt will most likely be in position to reorganize with honest management; however, until the statute is changed by Congress or until the decisions of the Supreme Court are changed, the Petitioners submit that they are entitled to a forfeiture whether the demand is for blood or otherwise. That represents the bankruptcy rule.

The Second Circuit emphatically stated, in *B.J.M. Realty Corp.* v. *Ruggieri, supra,* on Page 284, that:

> "Though we are loath to subject reorganization proceedings to disruption by permitting forfeiture of a lease, the landlord's contractual right cannot be disregarded without clear evidence that he intended to

abandon it. Cf. In re Wil-low Cafeterias, supra, 95 F. 2d at 309. Such evidence is lacking here. The decision of the District Court is reversed, and the case is remanded with instructions to grant the petition to compel vacation of the leased premises."

Collier on Bankruptcy, Volume 1, p. 209 (14th Ed.) (1962) states that:

> "The Bankruptcy Court . . . is a Court of equity. It will look through the form to the substance of any particular transaction and may contrive new remedies where those at law are inadequate. When the Bankruptcy Act is silent, equitable principles will govern, but the equitable powers of the Court are to be exercised within the limits laid down by the Act as subject to and consistent with any specific provisions contained in it."

It is interesting to note that no other court has ever cited the *Fleetwood* case as authority for denying a forfeiture although many of the cases still refer to the *Smith* v. *Hoboken Railroad Co., supra,* case as authority for forfeiture noting that the case was reversed for other reasons. See cases annotated under 11 U.S.C.A. 110, Note 247.

Carson v. *Imperial '400' National, Inc.*, 267 N.C. 229, 147 S.E. 2d 898 (1966), held that such a provision as contained in the present lease concerning forfeiture must be upheld, citing *Finn* v. *Meighan, supra.* See also 9 Am. Jur., 2d *Bankruptcy* § 1568.

In the *Carson* case, the plaintiffs and Imperial '400' National, Inc., executed a written lease in 1962 for a term of fifty-four (54) years. Imperial agreed that it would erect a two-story building on the lot to be used as a motel. The lessors agreed to subordinate their equities for sixteen (16) years, as did the Landlords in the instant case. On March 18, 1963, Imperial borrowed One Hundred Eighty-Five Thousand (185,000.00) Dollars pursuant to the terms of the lease and the plaintiffs secured the sums so borrowed by their mortgage on the demised property.

On June 3, 1965, Imperial filed a petition under Chapter

XI and alleged that it could not pay its debts as they matured and requested a receiver and the receiver was allowed by the United States District Court.

Amazingly, Paragraph 12 of the Carson Lease, as did the Weaver Lease, stated that a bankruptcy act would cause an immediate forfeiture. The Supreme Court of North Carolina stated:

> "The provisions of Section 12 authorizing plaintiffs-lessors to terminate the lease and repossess the property upon the appointment of a receiver for Imperial or adjudication that it was a bankrupt are not void. They are not contrary to public policy nor prohibited by statute. To the contrary, similar provisions are frequently inserted in leases, particularly when of long duration. *Finn v. Meighan,* 325 U.S. 300, 65 S. Ct. 1147, 89 L. Ed. 1624; *415 Fifth Avenue Co. Inc., v. Finn,* 2 Cir., 146 F. 2d 592; *In Re Clerc Chemical Corporation,* 3 Cir., 142 F. 2d 672; *Floro Realty & Investment Co. v. Stemm Electric Corp.,* 8 Cir., 128 F. 2d 338; *Urban Properties Corporation v. Benson, Inc.,* 116 F.2d 321; *In Re Walker, et al.,* 2 Cir., 93 F.2d 281; 51 C.J.S. *Landlord and Tenant,* § 80, p. 632; 32 Am. Jur., 735."

The Court further stated that:

> "They (the defendants) say provisions for forfeiture are to be strictly construed, ...
> "The answer to appellants' position is: There is no ambiguity in the language the parties used to express their agreement. . . . Courts cannot under the guise of construction rewrite contracts executed by the litigants. *Parks v. Venters Oil Company,* 255 N.C. 498, 121 S.E. 2d 850; *Fidelity & Casualty Co. of New York v. Nello L. Teer Co.,* 250 N.C. 547, 109 S.E. 2d 171."

The United States District Court for the Western District of North Carolina is in full accord with the Supreme Court of the United States and the Supreme Court of North Carolina. In the case of *Friendly Center, Inc., v.*

Robinson, 233 F. Supp. 274 (W.D.N.C. 1964), Judge Craven (now Circuit Judge for the Fourth Circuit) stated:

> "Beyond question, the Chapter X proceeding resulted in 'events of default' as enumerated in Paragraph 30 of the lease-hold agreement.[1] Also, beyond question express covenants of forfeiture such as contained in the lease[2] are enforceable against trustees in bankruptcy, including trustees in reorganization under Chapter X. *Finn v. Meighan,* 325 U.S. 300, 65 S. Ct. 1147, 89 L. Ed. 1624 (1945); and see 11 U.S.C.A. §§ 110, sub. b. and 502."

The Fourth Circuit, in its Order Denying the Petition for Rehearing, appears to now agree with the Petitioners that there was "an act of bankruptcy" below, and that the only issue is as herein set forth; however, without detailed elaboration at this time concerning the "Creditors' " Petition, the Petitioners show unto the Honorable Court that the Debtor directly committed an act of bankruptcy when it filed its Answer to the "Creditors' " Petition by admitting, or not denying, the material allegations of the "Creditors' " Petition.

As early as December 30, 1903, in the case of *Brinkley et al* v. *Smithwick,* 126 F. 686 (E.D.N.C.), the Court held that where a bankrupt admitted his insolvency in his answer to an involuntary bankruptcy petition, his willingness to be adjudged a bankrupt on that ground, as authorized by Bankr. Act, July 1, 1968, c. 541, § 3, Subsec. 5, 30 Stat. 546 [U.S. Comp. St. 1901, p. 3422], may be inferred. Further, the Court specifically held that when the answering debtor admitted insolvency, it committed an act of bankruptcy, and that the willingness to be adjudged a bankrupt in an involuntary proceeding could be treated as surplusage and that the bankrupt is supposed to have intended what he did when he filed his answer.

In a more recent case, *In Re Hudson & Manhattan Railroad Company,* 2nd Cir., 229 F. 2d 616, certiorari denied, 351 U.S. 982 (1956), the Court held that a debtor's answer, admitting its inability to meet it debts as they matured,

itself, constituted an act of bankruptcy. Further, the Circuit Court held that a pleading speaks for itself and its intent is to be discovered from what it discloses on its face. This case also arose under Chapter X of the Bankruptcy Act and is believed to be directly in point concerning whether or not the within tenant committed an act which would forfeit its lease.

Even the Third Circuit is in accord that the within tenant forfeited its lease when it admitted the material allegations of the "Creditors' " Petition. *In Re Technical Marine Maintenance Co., Inc.*, 3rd Cir., 169 F. 2d 548 (1948), the Third Circuit held that under a provision in the lease giving a landlord the option to terminate the lease in the event tenant should be adjudged a bankrupt or should take advantage of an insolvency act, tenant's acquiescence in involuntary reorganization proceedings gave the landlord the right to terminate the lease at its option. Bankr. Act. §§ 4, 101 et seq., 11 U.S.C.A. §§ 22, 501 et seq.

Unless the Supreme Court now desires to permit the Bankruptcy Courts to ignore Section 70 (b) of the Bankruptcy Act, as it pertains to reorganizations under Chapter X, it should exercise its powers to correct the decision below in accordance with the dictates of the Supreme Court, as set forth in *Finn* v. *Meighan, supra.*

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

CHARLES B. NYE
Nye & Mitchell
Attorneys at Law
P. O. Box 1131
Durham, North Carolina 27702
Telephone (919) 682-6191

CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that I have this date served three (3) true and correct copies of the foregoing Petition for Writ of Certiorari upon Mr. Richard M. Hutson, II., Trustee, 102 East Main Street, Durham, North Carolina 27701, Mr. William R. Winders, attorney for the Trustee, First Federal Savings & Loan Building, Durham, North Carolina 27701, Mr. Allston J. Stubbs, attorney for the Debtor, Home Savings & Loan Building, Durham, North Carolina 27701, Mr. Paul Gonson, Assistant General Counsel, Securities & Exchange Commission, Washington, D. C. 20549, and the Solicitor General, Department of Justice, Washington, D. C. 20530, by depositing same in the United States Post Office with first-class prepaid postage, addressed to each of them at their respective addresses indicated.

This the 13 day of June, 1972.

CHARLES B. NYE
Attorney for Petitioners

APPENDIX

APPENDIX A

IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA DURHAM DIVISION

In the Matter of
Landmark Inns of Durham, Inc.
Debtor

In Proceedings
for Reorganization
of a Corporation
B-198-69

Findings of Fact, Conclusions of Law, and Order

Upon the petition of the landlords claiming forfeiture of leasehold estate and for an order for possession of the leased premises now occupied by the debtor corporation; upon the answer of the debtor corporation and the Trustee in this Chapter X Reorganization Proceeding, and upon hearing the evidence, arguments of counsel, briefs submitted by counsel, including counsel for the Securities and Exchange Commission, facts and conclusions of law are found and made as follows:

Findings of Fact

1.

Coy L. Weaver and wife, Helen F. Weaver, are the owners of a certain tract of land situated on the north side of Erwin Road in the City of Durham, North Carolina, known and designated as 2424 Erwin Road, acquired by them in 1942 for about $3,100.00. The value of said land, without the building, at the time of this hearing, is $150,000.00. This land is irregularly shaped and slopes downhill at a rather sharp grade to the rear.

2.

The lot or tract of land is 0.7 miles from Duke University Hospital and is immediately adjacent to the Veterans

Administration Hospital. The nearest highway to the property is about one and one-half miles away.

3.

W. H. Troutman, the promoter and Vice President of Landmark Inns Corporation, first became interested in this site in May, 1963. He obtained a topographical survey and turned it over to James A. Livingston, an architect from Ann Arbor, Michigan, who did a preliminary plan for a motor hotel to be erected on the premises.

4.

It was contemplated by the original investors that a motor hotel could and would be built on the Weaver site, which said hotel would be a hotel related to Duke University Hospital and that the bulk of the business done by the hotel would come from patients and persons visiting patients at Duke University Hospital and Duke University. This was communicated to the Weavers, who subsequently became the landlords, and they knew that stock would have to be sold to the public to finance the venture before any lease agreement was entered into.

5.

On March 27, 1964, a lease agreement was entered into by and between Coy L. Weaver and wife, Helen F. Weaver, hereinafter referred to as landlords, and Landmark Inns Corporation. The lease was for a term of fifty-two (52) years and provided for a minimum annual rental of $19,159.00, with a further provision for additional payments to be made at the end of each operating year based on gross income in certain instances and net profit in other instances. The ascertainment of the overage due the landlords, if any, would be based upon an independent audit by a certified public accountant, satisfactory to the landlords, within sixty (60) days from the end of each operating year. The pertinent paragraphs of the lease involved in this proceeding are as follows:

Paragraph 12 of the lease provides:

"This lease shall be terminated by any act of the

Tenant, the result of which would be to pass by operation of law, or otherwise, any interest or estate in the leased premises to any Trustee or Receiver in bankruptcy . . ."

Paragraph 19 of the lease provides:

"No delay or omission by either party hereto to exercise any right or power accruing upon any non-compliance or default by the other party with respect to any of the terms hereof shall impair any such right or power or be construed as a waiver thereof. Every such right and power may be exercised at any time during the continuance of such default. It is further agreed that a waiver by either of the parties hereto of any of the covenants and agreements hereof to be performed by the other shall not be construed to be a waiver of any succeeding breach thereof or of any other covenants or agreements herein contained."

Paragraph 23 of the lease provides:

"It is further understood and agreed that the tenant shall have the right under Paragraph 4 of this lease (Paragraph 4 pertained to the erection of buildings or improvements on the demised premises) to enter into a mortgage or deed of trust, joined in by the landlord, for purposes of obtaining a construction loan, or loans, if necessary."

6.

The lessee was required to construct upon the leased premises a modern motor hotel containing not less than one hundred thirty-eight (138) rooms, together with commercial facilities, and the landlords agreed to join with the tenant in the execution of a mortgage on the demised premises for the construction of improvements on the premises. The lease does not specify the amount of the mortgage, but does limit its amortization to a period of sixteen (16) years. The tenant was responsible for insurance, taxes, utilities, improvements and all maintenance

thereof, under the terms of the lease, making rental payments net to the landlords.

7.

After the execution of the lease, W. H. Troutman, the promoter and Executive Vice President of Landmark Inns of Durham, Inc., the debtor corporation, embarked on an ambitious plan of selling stock and debentures in the debtor corporation to various persons. Coy L. Weaver, one of the landlords, supplied Mr. Troutman the names of various potential purchasers of stock and debentures in the local area. During a period of time, before and after the construction of the hotel on the premises, Troutman sold to eighty-four (84) stockholders the sum of $325,489.00 worth of common stock at $1.00 par value, to seventy-seven (77) debenture holders $254,750.00 worth of convertible debentures, and to fourteen (14) persons the sum of $100,500.00 worth of non-convertible debentures. None of the stocks or bonds were registered with the Securities and Exchange Commission.

8.

On April 10, 1965, Landmark Inns Corporation assigned to Landmark Inns of Durham, Inc., the debtor corporation, the lease which it had entered into on March 27, 1964. The assignment was approved by the landlords and they agreed that the assignee was not in default under the terms of the lease at that time. The debtor corporation as assignee obligated itself to perform all the obligations of the lease that were imposed upon the original lessee and the debtor corporation is now fully bound under all the terms and conditions of the lease agreement dated March 27, 1964.

9.

A commitment dated July 13, 1964, was made by the Penn Mutual Life Insurance Company to purchase a leasehold loan in the sum of $730,000.00 secured by a first deed of trust on the premises upon completion of the improvements ready for occupancy. The interest rate on this loan was originally six percent (6%) but due to delays the

commitment was extended and the interest rate was increased to six and one-quarter percent (6-¼%), with the first monthly installment due on August 1, 1966.

10.

The debtor corporation began construction of the modern motor hotel in June, 1965. Due to expanded plans and specifications, the hotel built on the leased premises contains one hundred forty-five (145) rooms and baths and is eight stories high. It is built of reinforced concrete, steel and glass. It has a stone masonry under-drive canopy at the front and provides paved parking area for two hundred and twenty (220) cars at the front and sides. It is a totally electric building, containing complete restaurant facilities, cocktail lounge, beauty parlor, barber shop, and three elevators. During the construction of the building and subsequent thereto, the debtor corporation was required to make further investments and improvements on the leasehold estate as follows:

7 rooms @ $11,000	$ 77,000.00
Coffee Shop	9,400.00
Esso lot purchased, filled & paved	15,500.00
Modify Restaurant Plan (Hilton requirement)	22,000.00
Modify Room plan (Hilton requirement)	11,500.00
Install culvert over creek	4,500.00
Increase in furniture	23,000.00
Hilton franchise & sign	13,175.00
Increase in construction cost 6%	64,175.00
Community Health Addition (1967)	35,000.00
TOTAL	$275,250.00

The total fixed assets now owned by the corporation, excluding depreciation, are as follows:

Land (Parking Lot)	$ 6,621.25
Leasehold Improvements:	
Landscaping and Paving	31,565.48
Building Cost	1,143,931.08
Furniture, Fixtures and Equipment	315,225.79
Automobile (Shuttle Bus)	5,301.52
TOTAL COST	$1,502,645.12

The fair market value of the land, buildings, furniture and equipment at the present time is $2,000,000.00 The present fair market value of the land is $150,000.00. The $2,000,000.00 total appraisal is substantiated from an "income approach" as well as "replacement cost." Building costs have increased thirty (30%) percent since the hotel was constructed.

The landlord, Coy L . Weaver, made monthly or more frequent visits to the premises and was constantly aware of the further improvements, investments and additions over the original construction contract made by the debtor corporation. Before and after the opening of the hotel he came by regularly to pick up his monthly rental check. During his frequent visits the landlord had an opportunity to observe the overall operations of the hotel, consult with the manager, and inspect the physical facilities of the building. The landlord was familiar with all facets of the operation, building improvements and changes, and was also aware of the various lease commitments to Duke University Hospital.

11.

The hotel was completed during the summer of 1966 and held its grand opening on July 30, 1966, as a Statler-Hilton Inn. Because of increased costs, financial difficulties were encountered. Funds were not available to complete payment of labor and materials. Materialmen threatened to file liens against the land and building. The debtor corporation approached the landlords for help in acquiring additional

financing. On October 4, 1966, the debtor and the landlords executed a second unamortized mortgage to the Chase Manhattan Bank in the sum of $110,000.00. The funds secured thereby and additional corporate funds, together which totaled about $150,000.00, were used to pay off the contractors, sub-contractors and materialmen for work and materials used in the construction of the hotel. This mortgage was for a term of two years and there was no amendment to the lease reflecting this additional financing. The landlords received two $1,000.00 debentures and their attorney, Charles B. Nye, was paid $500.00 as additional consideration for executing the second mortgage.

12.

Due to financial difficulties from the original financing, lack of occupancy, additional improvements beyond the original plans and specifications and pressure of trade creditors, the operation of the hotel got off to a bad start. There were constant bickerings among the officers and directors, principally due to management. The rent was not paid annually in advance, as required by the lease agreement, but the landlords agreed that the rent could be paid on a monthly basis, with interest on the deferred balance. The only exception to this arrangement was that the basic annual rental for the fiscal year ending April 30, 1970, was paid in one lump sum in advance on June 7, 1969.

13.

The original lessee and the debtor corporation began paying rent to the landlords on April 3, 1964, and continued to do so for a period of twenty-eight (28) months prior to the opening of the motel. The payments to the landlords of rent, including a small amount of interest on deferred payments, before and after construction of the hotel, are as follows:

April	3, 1964	—	$ 3,000.00
April	15, 1964	—	3,000.00
July	21, 1964	—	2,500.00
September	18, 1964	—	2,062.50

December	9, 1964	—	3,187.40
February	1, 1965	—	1,595.00
February	1, 1965	—	1,595.00
May	1, 1965	—	1,595.00
June	11, 1965	—	624.10
June	11, 1965	—	1,595.00
July	7, 1965	—	1,595.00
August	11, 1965	—	500.00
September	10, 1965	—	1,095.00
September	20, 1965	—	500.00
October	4, 1965	—	1,095.00
October	8, 1965	—	500.00
October	10, 1965	—	1,095.00
November	12, 1965	—	500.00
November	26, 1965	—	1,095.00
December	7, 1965	—	1,095.00
December	10, 1965	—	500.00
January	10, 1966	—	500.00
January	19, 1966	—	1,095.00
February	14, 1966	—	500.00
March	17, 1966	—	2,190.00
April	23, 1966	—	1,500.00
May	18, 1966	—	1,595.00
June	3, 1966	—	595.00
June	10, 1966	—	1,595.00
July	22, 1966	—	1,595.00
August	12, 1966	—	1,595.00
September	8, 1966	—	1,595.00
October	10, 1966	—	1,595.00
November	8, 1966	—	1,595.00
December	2, 1966	—	1,595.00
January	9, 1967	—	1,595.00
February	1, 1967	—	1,595.00
March	3, 1967	—	1,595.00
April	7, 1967	—	1,595.00
May	1, 1967	—	1,595.00
June	7, 1967	—	2,159.00
July	1, 1967	—	500.00

July	1, 1967	—	500.00
July	1, 1967	—	500.00
July	1, 1967	—	157.50
August	1, 1967	—	1,600.00
August	8, 1967	—	27.25
September	6, 1967	—	1,619.50
October	2, 1967	—	1,611.75
October	17, 1967	—	500.00
October	26, 1967	—	104.00
October	28, 1967	—	596.25
January	1968	—	1,588.50
February	1968	—	1,580.75
March	1968	—	1,573.00
April	1968	—	1,565.25
May	1968	—	1,507.50
June	1968	—	2,159.00
July	1968	—	1,635.00
August	1968	—	1,627.25
September	1968	—	1,619.50
October	1968	—	1,600.00
October	1968	—	11.75
November	1968	—	1,604.00
December	1968	—	1,596.25
January	1969	—	1,588.50
February	1969	—	1,580.75
March	1969	—	1,573.00
April	1969	—	1,565.25
May	1969	—	1,507.50
June	1969	—	1,600.00
June	1969	—	16,051.50
August 8	1969	—	4,634.55
	TOTAL		$117,083.05

14.

During the month of May, 1969, the landlords, by and through their attorney, advised the debtor corporation that it must pay the balance of the basic rent for the fiscal year

ending April 30, 1970, in advance, as called for in the lease, and this was paid on June 7, 1969, covering the period from May 1, 1969, through April 30, 1970. Thereafter, on August 8, 1969, the debtor paid to the landlords $4,634.55, which said amount represented the estimated overage for the fiscal year ended April 30, 1969. This amount was ascertained pursuant to the audit furnished by Harris, Kerr, Forster & Company, accountants of Atlanta, Georgia, and was paid as soon as the information was received.

15.

On June 7, 1969, when the basic annual rental was paid for the year ending April 30, 1970, and accepted by the landlords, the accountants for the debtor were Harris, Kerr, Forster & Company and the landlords knew this at the time of the acceptance of said rental and the same situation prevailed at the time of the acceptance of the overage, based on said audit, on August 8, 1969.

16.

With the payment of the overage on August 8, 1969, the landlords admitted that they have been paid rent in full. On April 28, 1970, the Trustee for the debtor corporation paid to the landlords the basic annual rental for the fiscal year ending April 30, 1971, in the amount of $19,159.00, and on June 29, 1970, an overage of $7,425.58, making a total rent paid in the sum of $26,584.18 for the fiscal year beginning May 1, 1969, through April 30, 1970. These payments were received by Charles B. Nye, attorney for the landlords, with a consent stipulation that it was without prejudice.

17.

An annual audit was made by the firm of Harris, Kerr, Forster & Company, of Atlanta, Georgia, for the fiscal years ending April 30, 1967, April 30, 1968, and April 30, 1969. The accountant who supervised the annual audit was Mr. Anthony DiPola, a licensed Certified Public Accountant in the State of Georgia. The firm of Harris, Kerr, Forster & Company is one of the leading hotel and motel auditing firms

in the business, with an excellent national reputation and having offices in Atlanta, New York, Boston, Chicago, Honolulu, and other large cities in the United States. In addition, Harris, Kerr, Forster & Company publish a magazine known as "Trends in the Hotel-Motel Business." This firm is a highly competent and capable organization and at no time have the landlords directed any criticism to any phase of their work as being substandard or non-professional.

18.

Any licensed certified public accountant from another State can do business in North Carolina by comity and can receive a certificate to do business merely by going by the office of the Secretary of the North Carolina Certified Public Accountant Board in Chapel Hill, exhibiting his license and paying $1.00.

19.

On November 18, 1968, the landlords, through their attorney, Charles B. Nye, notified one of the directors of the debtor corporation, Dr. Frank H. Bassett III, by letter of that date, that they were insisting on a local certified public accountant and that the firm of Harris, Kerr, Forster & Company did not meet with their approval. Prior to the receipt of this letter the tenant had never been advised by the landlords or their attorney that the Atlanta firm was not satisfactory to them to do the annual audit of the books of the corporation.

The landlords did not object to the audit prepared by the firm of Daniels and Daniels in 1966, neither did they object to the audits furnished by the firm of Harris, Kerr, Forster & Company for the years 1967 and 1968. The landlords did consent to or at least acquiesce in the use of said firms to audit the books of the debtor corporation and no material objections were advanced by the landlords for any change in auditors, except that they desired local accountants to do the annual audit. The Trustee has complied with the change of auditors by retaining a local accountant, with the approval of the landlords.

Even though the landlords stated that this firm was not satisfactory to them on November 18, 1968, they have never complained of any audit submitted by said firm, nor have they to this date contended that any further monies are owing to them under the terms of the lease.

20.

After being advised that this accounting firm was not satisfactory, the debtor corporation attempted to secure a local accounting firm satisfactory to the landlords. Several conferences were held with Philip W. Hutchings, a local Certified Public Accountant acceptable to the landlords, but no decision was ever made to hire Mr. Hutchings in that he advised in the summer of 1969 that he could not do the audit for the year ending April 30, 1969. Prior to receiving the letter of November 18, 1968, the Atlanta firm had already been employed and had commenced its audit for the year ending April 30, 1969. During all of the time that the landlords were being paid on a monthly basis prior to the date of November 8, 1968, they had never complained about any annual audit, even though they were coming by the hotel to pick up the monthly installment of rental checks; neither did the landlords utter any complaint about who was doing the audit, upon receiving the balance of the basic rental for the year ending April 30, 1970, when accepted by them on June 7, 1969. The only objection to the audit done by Harris, Kerr, Forster & Company was that they were not local accountants and no objection has ever been made as to the quality or the accuracy of any annual audit done by said firm. This refusal to approve the firm of Harris, Kerr, Forster & Company was merely an arbitrary refusal on the part of the landlords and was based on no valid objection.

21.

The second mortgage in the sum of $110,000.00 due the Chase Manhattan Bank was not paid on the date due, which was September 22, 1968, and the debtor corporation received two extensions thereon. In May 1969, after threats of foreclosure were received on said mortgage, it was purchased

from the holder thereof by five major stockholders of the debtor corporation, namely, William H. Troutman, James H. Livingston, Dr. Frederick M. Wilson, Frank Conner, and Robert C. Troutman. The note and deed of trust were assigned to Oliver W. Alphin, Trustee for the five purchasers. These persons purchased the mortgage to prevent its foreclosure and to prevent said corporation from losing all of its assets The mortgage was then assigned to Central Carolina Bank and Trust Company, of Durham, North Carolina, as collateral for debtor corporation's note of $25,000.00, which proceeds the corporation used to pay its basic annual rental for the year ending April 30, 1970, and to pay one delinquent mortgage payment to the holder on the first mortgage. In addition to supplying the collateral, the individuals personally guaranteed the repayment of the $25,000.00 borrowed by the debtor corporation for this purpose. The foreclosure of the $110,000.00 mortgage has now been restrained by this Court and will have to be paid on any plan submitted for reorganization of the corporation. At the time of the purchase of the mortgage by five primary stockholders they indicated to the landlords and gave them their assurance that there would be no foreclosure under this mortgage. The President of the corporation, Dr. Frederick M. Wilson, stated that he considered the amount of the purchase price paid by him for the mortgage as a contribution to capital.

22.

The landlords, through their attorney, have objected to the leases of certain transient rooms and other areas to Duke University, contending that the hotel was built to rent transient rooms and it was not anticipated that long term leases would be entered into which would deprive them of some of their income. However, the lease does not restrict the use of said facilities to transient guests. It was contemplated at the time of leasing the land from the landlords that the motor hotel to be erected on the premises would be one related to Duke University Hospital and the bulk of the business of said hotel would come from Duke Hospital

and Duke University. The occupancy rate at the hotel during the first two years of its operation was very low and the Duke leases have inured considerably to the income of the landlords. The rental paid by Duke exceeds $13,000.00 per month and the price paid for the leased rooms is based on 80% of the regular commercial rate. Attached to Trustee's Exhibit No. 3, which is the audit for the fiscal year ending April 30, 1968, Schedule 7 shows the following leases to Duke University:

Lease No. 1—46 rooms known as Drake Pavillion Monthly rental $10,500.00

Lease No. 2—To National Institute of Health Monthly rental 696.66

Lease No. 3—To Community Health Science Monthly rental 393.75

(This space was added in 1967 at the expense of the debtor corporation and is not a part of the 145 rooms originally constructed.)

Lease No. 4—Leased to Psychiatry for study of the Aged—Two rooms, Monthly rental 233.50

(These two rooms are located directly below the kitchen and dishwashing area and are not suitable for transient use.)

Lease No. 5—Private Diagnostic Clinic—On the first floor, which is primarily below the ground level—Monthly rental 1,315.23

The rooms leased to Duke University are not the most desirable ones in the hotel. Generally, these rooms are concentrated in the lower floors of the hotel, which are below the level of the lobby. The physical appearance of said rooms has not been changed from their use as transient guest bedrooms. This allows ambulatory patients of Duke Hospital to enjoy the comfort of hotel surroundings rather than the atmosphere of a hospital facility.

The area of the hotel leased to Duke University has been licensed by the North Carolina Board of Health as a medical facility and patients living in the hotel who subscribes to medical insurance receive their benefits thereunder the same as if they they were patients in Duke University Hospital.

All of the directors of the tenant were of the opinion that the Duke leases were beneficial to the landlords and to the tenant. Rountree Crisp, the M.A.I. appraiser who testified in this hearing, is also of the opinion that the Duke leases are a definite asset to the hotel operation, and the Trustee in this corporate reorganization is of the opinion that the leases are vital to the operation of the hotel and that it could not continue to operate without them.

The Drake Pavillion rooms leased to Duke were leased on a buy-back basis which enables the debtor corporation to re-purchase any of these rooms on any night that they are not being used by Duke University, and when needed by the tenant, for the sum of $9.00 per room. The landlords never complained to the tenant about the Duke leases until their attorney began to complain in November 1968.

Before the leases to Duke University and through and including the April 30, 1968, audit, there was never any overage paid under the terms of the lease agreement in that there was not sufficient income on which to pay overage under the terms of the lease. Because of the Duke leases and the persons attracted to the hotel because of same, the income was sufficient in the fiscal years ending April 30, 1969, and April 30, 1970, to pay overages in the amounts of $4,634.55, and $7,425.28, respectively, making the total annual payments received of $23,793.55 and $26,584.18 net to the landlords.

23.

After the acceptance of the overage due the landlords on August 8, 1969, based on the Harris, Kerr, Forster & Company audit, which they admit was all that was due them, the landlords did on August 15, 1969, institute a summary ejectment proceeding in the General Court of Justice,

District Court Division, in Durham, North Carolina, against the debtor corporation on the grounds of breach and forfeiture of the lease. Prior to the hearing in District Court in Durham County, three creditors of the corporation filed a petition in this Court for a reorganization of the debtor corporation and an answer was filed on behalf of said corporation. The petition filed for this corporate reorganization proceeding was not instituted by the tenant, but by three creditors of the tenant. Paragraph 12 of the lease agreement dated March 27, 1964, provides in part:

> "This lease shall be terminated by any act of the tenant, the result of which would be to pass by operation of law, or otherwise, any interest or estate in the leased premises to any trustee or receiver in bankruptcy—all estate as hereby leased shall hereby revert to the landlord without notice to the tenant and without further conveyance, including all assets, personal property and improvements of the tenant then on the premises."

24.

On September 12, 1969, Edwin M. Stanley, Chief Judge of the United States District Court for the Middle District of North Carolina, approved the creditors' petition placing the debtor corporation in a Chapter X Reorganization Proceeding and in said order restrained and stayed the action for summary ejectment instituted by the landlords in the state court. Richard M. Hutson II was appointed by the Court as Trustee and he immediately entered into his duties and continued to operate and does now operate the hotel located on the demised premises known as "The Hilton Inn." Upon assuming his duties as Trustee in this corporate reorganization proceeding, Mr. Hutson discharged the General Manager, William H. Troutman. Mr. Troutman was also Executive Vice President of the debtor corporation and a member of its Board of Directors. The Trustees also discharged several members of Mr. Troutman's immediate family who were employees of debtor corporation. Under the surveillance and guidance of the Trustee in this proceeding the hotel has shown substantial increases in income

and profits over the corresponding months for the preceding year. The Trustee has submitted monthly reports to the court, creditors, stockholders, and the landlords showing an average occupancy rate of approximately ninety percent (90%). The Trustee has shown a net profit for each month's operation after payment of all monthly installments due holders of security instruments totalling $13,285.61, which includes the first mortgage on the real estate to Penn Mutual Insurance Company (this payment is in the amount of $8,400.00) and the personal property of the debtor corporation which he is using on the demised premises. The Trustee has paid taxes, utilities, and all trade accounts in full on or before the tenth day of each month in order to take advantage of the trade discounts and all of the insurance is paid on the premises and its contents up to and including September 1970. The Trustee has made available to transient guests twelve additional rooms by disallowing any employee to live on the premises, which action has increased the income of the debtor corporation and which will inure to the benefit of the landlords. The Trustee has negotiated new leases with Duke University which have also considerably increased the income of the debtor corporation. As of February 1, 1970, the first mortgage to Penn Mutual Insurance Company has been reduced from $730,000.00 to $613,590.00 and the Trustee has continued to pay the monthly installment on said mortgage until the present time. The monthly installment also includes an escrow for current ad valorem taxes for the City and County of Durham, North Carolina.

25.

The present value of the building, furniture, fixtures and equipment of the debtor corporation is $2,000,000.00. The landlords have subordinated their interest to two real property mortgages, the first mortgage having a present balance of approximately $590,000.00 and the second mortgage balance being $110,000.00. In addition, the following creditors have filed claims with the Trustee:

Preferred Creditors	$ 37,614.04
Secured Creditors (less mortgages on real estate)	277,113.21
General Creditors	236,505.36
Convertible Debentures	199,228.02
Non-Convertible Debentures	103,583.18
Outstanding Capital Stock	301,600.00

If the landlords are permitted a forfeiture under the terms of the lease, they will take possession of the assets of this corporation subject to the two real property mortgages and other secured claims having a total of $1,009,732.09. The remaining preferred creditors, general creditors, debenture holders and stockholders will lose their entire claims which total $878,530.60.

26.

The Trustee has been ordered to present to the Court a plan of corporate reorganization, but if the landlords are permitted a forfeiture under the terms of the lease agreement there will be absolutely no assets to reorganize, and the investing public, preferred and general creditors will receive nothing on their claims, because the only assets of debtor corporation are the hotel erected by it on the premises and the equipment and fixtures located thereon. On the other hand, to permit a forfeiture the landlords would receive a windfall of $990,267.91. A plan of corporate reorganization at this time would be premature prior to the determination of this cause.

27.

The trustee has received many inquiries on presenting a plan of reorganization, which include Duke University, Hilton Hotels, Inc., Wedgewood South, Inc., which operates Hilton Inns in Winston-Salem, Raleigh, and Greensboro, North Carolina, and Ramada Inns. Interested persons, who would like to file plans of reorganization with the Trustee, have been shown the audit for the year ending April 30, 1969, at the time of their inquiries, and notwithstanding

prior losses they are still definitely interested in submitting plans.

28.

In the taking of the deposition of Coy L. Weaver, one of the landlords, who at all times was acting for his wife, Helen F. Weaver, in this matter, he stated that he would go along with the reorganization of the corporation if they take care of the $110,000.00 mortgage and live up to the lease agreement, that he would be happy. Precisely, Mr. Weaver, in his deposition, stated: "If they'll take care of the second mortgage, I'll be happy."

29.

At the hearing of the matter in February he stated that he would have to discuss this matter with his attorney to see if it would be to his advantage. He also stated that it would bother him to see all the creditors and investors lose all the money they have in the venture if he won the law suit.

30.

The landlords are content with the present management of the hotel and are happy with the amount of rental they are receiving and have indicated a willingness to go along with a reorganization that would live up to the lease agreement. The landlords have shown a definite lukewarm attitude towards pursuing this lawsuit and insisting upon a forfeiture.

31.

It is found as a fact:

A. The costs of the hotel exceeded the basic construction contract of $925,000.00 by some $275,000.00, exclusive of furnishings and equipment. The fixed assets owned by the debtor corporation cost $1,502,645.12, and the fair market value of the land, building, furniture and fixtures is $2,000,000.00

B. The value of the real property owned by the landlords and leased to the debtor corporation, excluding improvements by the corporation, is $150,000.00.

C. As of February 1, 1970, the original note of $730,000.00, secured by first mortgage, was reduced to $613,590.00.

D. As of the date of the institution of this action, landlords had been paid all rentals and overage amounts due them through April 30, 1970.

E. As of the date of the institution of this action, the landlords had received total rentals, plus interest on deferred payments, in the sum of $117,033.05.

F. All Certified Public Accountants retained by the tenant were qualified and independent. The firm of Harris, Kerr, Forster & Company, of Atlanta, is a nationally known accounting firm specializing in the hotel-motel accounting field.

G. The landlords' act of joining in the second deed of trust inured to their benefit; otherwise, the building could not have been fully completed, materialmen's liens would have been filed, executions would have issued, and foreclosure would ultimately have ensued.

H. The investing public consists of eighty-four (84) shareholders owning 325,867 shares of common stock of a par value of $1 per share, and seventy-seven (77) debenture holders owning $355,250.00 in debentures and because of this large number of investors the public interest is affected.

I. The various Duke leases and other space leases add stability to the investment as a going concern.

J. The building is duly licensed by the State of North Carolina to serve ambulatory patients receiving treatment at Duke University Hospital and qualifies as a medical hotel.

K. The Trustee's operation has been highly successful and all installments on secured debts have been promptly made. The operation has been accumulating earnings due in part to a substantial tax loss carry-over. The landlords have been paid the $19,159.00 basic rental for the year ending April 30, 1970, and in addition thereto, the Trustee did on June 29, 1970, pay an overage amount of $7,425.58, making a total rental payment for the fiscal year ending April 30, 1970, in the amount of $26,584.58 and the basic

rental for the year ending April 30, 1971, in the sum of $19,159.00 has been paid by the Trustee.

L. The debtor corporation is not and was not insolvent at the time of the filing of the creditors' petition, but simply was short of working capital. From its inception, the debtor corporation was inadequately financed.

M. To permit a forfeiture of the leasehold estate would be inequitable and unconscionable and would result in a windfall to the landlords of $990,267.91 at the hearing of this matter on February 18, 1970. This windfall as of this date would exceed $1,000,000.00, due to the monthly payments made by the Trustee to secured creditors. The windfall to the landlords would be at the expense of the general and preferred creditors and investing public involved in this proceeding, who have filed claims in this proceeding totalling $878,530.60. The landlords have not been damaged and their additional security far exceeds the amount due on the second mortgage and any forfeiture would be grossly unjust.

N. The Securities and Exchange Commission has petitioned this Court to become a party to this action because of a sufficient public interest pursuant to the terms of Section 208 of Chapter X of the Bankruptcy Act (11 U.S.C., Sec. 608), which provides that upon filing a notice of its appearance in a proceeding under that chapter:

> ". . . the Commission shall be deemed a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge . . ."

Conclusions of Law

32.

Upon the signing of the Order by Edwin M. Stanley, Chief Judge of the United States District Court for the Middle District of North Carolina, on September 12, 1969, there was a general reference of this case to the under-

signed Referee in Bankruptcy for matters which he could determine as Referee. All other matters were referred to him as Special Master.

The Referee in Bankruptcy has the authority and jurisdiction to determine the questions involved in this hearing by reason of Section 196 of the Bankruptcy Act, which states in part:

> "Objections by any party in interest to the amounts of any such claims or interest shall be held and summarily determined by the Court." (Underscoring Supplied)

Section 106, Sub-section (1) of the Bankruptcy Act provides:

> " 'Claims' shall include all claims of whatever character against a debtor or its property, except stock, whether secured or unsecured, liquidated or unliquidated, fixed or contingent."

Section 1 of the Bankruptcy Act defines the word "Court" to include the Judge or the Referee.

33.

The assignment of the lease by Landmark Inns Corporation to debtor corporation, Landmark Inns of Durham, Inc., on April 10, 1965, with the approval of the landlords, binds the debtor as fully as if it were the original tenant.

34.

The landlords are not entitled to a forfeiture of the lease for failure of the tenant to pay rent. The tenant has paid rent and interest in the amount of $117,083.05 through August 8, 1969. This amount includes the basic annual rent in advance through April 30, 1970. Since the hearing, the Trustee has paid the basic rental in the amount of $19,159.00, in advance, for the fiscal year ending April 30, 1971.

North Carolina General Statutes, Section 42-33, provides as follows:

> "If, in any action brought to recover the possession of demised premises upon a forfeiture for the nonpay-

ment of rent, the tenant, before judgment given in such action, pays or tenders the rent due and the costs of the action, all further proceedings in such action shall cease. If the plaintiff further prosecutes his action, and the defendant pays into court for the use of the plaintiff a sum equal to that which shall be found to be due, and the costs, to the time of such payment, or to the time of a tender and refusal, if one has occurred, the defendant shall recover from the plaintiff all subsequent costs; the plaintiff shall be allowed to receive the sum paid into court for his use, and the proceedings shall be stayed."

This section contemplates an action brought for forfeiture for nonpayment of rent which is not the instant case in that the rent was fully paid prior to the institution of any action by the landlords. However, it points out that a forfeiture will not be granted in this jurisdiction for failure to pay rent if a tender is made any time before judgment.

35.

The landlords accepted all rents due them under the lease, without objection as to the amount, and this constitutes a waiver of any right to termination of the lease on the ground of nonpayment of rent.

In the case of *Fairchild Realty Co.* v. *Spiegel, Inc., and Morrison-Neese, Inc.*, 246 N.C. 458, 185 S.E.2d 871 (1957), the landlord continued to receive rent from his tenant after full knowledge of a breach of a contract or condition in his lease. The Court in applying the doctrine of waiver, quoted from the principles laid down in *Winder* v. *Martin*, 183 N.C. 410, 111 S.E. 708 (1922):

"It is the generally accepted rule that if the landlord receive rent from his tenant, after full notice or knowledge of a breach of a covenant or condition in his lease, for which a forfeiture might have been declared, such constitutes a waiver of the forfeiture which may not afterwards be asserted for that particular breach, or any other breach which occurred prior to the ac-

ceptance of the rent. Or to state the rule differently, it is generally held that the acceptance of rent by the landlord, with full knowledge of a breach in the conditions of the lease, will ordinarily be treated as an affirmation by him that the contract of lease is still in force, and he is thereby estopped from setting up a breach in any of the conditions of the lease and demanding a forfeiture thereof."

This rule is overwhelmingly supported in numerous jurisdictions. See *Hart* v. *Shell Oil Co.*, 116 F.2d 298; *Reno Realty Co.* v. *Horstein*, 301 P.2d 1051; *Obedin* v. *Mesullo*, 191 N.Y.S.2d 254, and *B.J.M. Realty Corp.* v. *Ruggiere*, 2d Cir., 326 F.2d 281 (1964).

The landlords attempted to reserve their rights to declare a forfeiture in a letter to the tenant dated August 9, 1969, in which it was started: "We do not intend to waive any of the past breaches of the contract."

The case of *Wollard* v. *Schaffer Stores Co.*, 5 N.E.2d 829, decided by the New York Court of Appeals, *is directly in point*. There the landlord, after learning of the breach of the covenant, accepted rents with this reservation:

> "Any rentals you may pay hereafter will be received by me only with the understanding that the same are received without prejudice to the action which will follow your failure to comply with my notice of September."

The notice referred to was that the lease had terminated by the breach. The New York Court held that the acceptance of rent, notwithstanding the notification and reservation, waived the landlord's right to terminate the lease.

The attempt of the landlords to preserve their rights after the acceptance and payment of the overage was completely ineffective.

36.

The landlords contend that the lease, in Paragraph 19, provides that the parties have stipulated that the receipt of rents shall not be deemed a waiver.

Paragraph 19 of the lease provides as follows:

> "No delay or omission by either party hereto to exercise any right or power accruing upon any non-compliance or default by the other party with respect to any of the terms hereof shall impair any such right or power or be construed as a waiver thereof. Every such right and power may be exercised at any time during the continuance of such default. It is further agreed that a waiver by either of the parties hereto of any of the covenants and agreements hereof to be performed by the other shall not be construed to be a waiver of any succeeding breach thereof or of any other covenants or agreements herein contained."

It is a well settled principle of law and equity that contractual provisions for forfeiture are looked upon with disfavor and are strictly construed against the party seeking to invoke them. 32 Am. Jur., *Landlord and Tenant,* Sec. 848; *Finn* v. *Meighan,* 325 U.S. 300, 65 S.Ct. 1147, 89 L.Ed. 1624 (1944); *Morris* v. *Austraw,* 269 N.C. 218.

Paragraph 19 was not a non-waiver provision in the same light as contended by the landlords. When reading Paragraph 19 it is easily understood that the parties did consider the possibility of a waiver because they stated that any waiver was not binding on a succeeding breach of the same covenant. The landlords did, in fact, waive their right to terminate the lease by acceptance of rent.

37.

The continued acceptance of rent by the landlords after their objection to the auditors constitutes a waiver of any breach of the lease on this ground. The cases of *Fairchild Realty Co.* v. *Spiegel, Inc., and Morrison-Neese, Inc., supra,* and *Winder* v. *Martin, supra,* are clear authority for the principle of waiver applicable to this condition of the lease, as well as that of the failure to pay rent. The landlords had full knowledge of the auditors, who were going to do the annual audit for the fiscal year ending April 30, 1969, when they accepted the basic rental for the ensuing year in ad-

vance on June 7, 1969. The landlords went much further in waiving the objection to the accountants by acceptance of the overage in the amount of $4,634.55, based on figures prepared by Harris, Kerr, Forster & Company. This acceptance constituted a complete and absolute waiver and the landlords are now estopped to claim such a breach.

38.

The failure of the debtor to repay the $110,000.00 note secured by a mortgage to Chase Manhattan Bank when the same became due is not a breach of the lease agreement dated March 27, 1964.

Nowhere in the lease agreement is there any provision regarding the payment of the $110,000.00 note. In fact, the covenants and conditions in the lease agreement do not provide for any breach of the same in the event of default of promissory notes secured by deeds of trust on the demised premises.

In Paragraph 23 it is stated:

> "It is further understood and agreed that the tenant shall have the right under Paragraph 4 of this lease (Paragraph 4 pertained to the erection of buildings or improvements on the demised premises) to enter into a mortgage or deed of trust, joined in by the landlord, for purposes of obtaining a construction loan, or loans, if necessary."

Actually, the funds received from Chase Manhattan Bank on the $110,000.00 note, secured by a mortgage, were used along with other corporate funds in the total sum of approximately $150,000.00 to pay off in full the contractor, subcontractors, and materialmen, for work performed by them in constructing the premises.

Furthermore, the landlords received two $1,000.00 debentures and their attorney received the sum of $500.00 in consideration of their executing the $110,000.00 note and mortgage. Of course, the debtor corporation and tenant intended to pay the note, when due, and cancel the same from the record. But the landlords and the tenant knew this debt could not be paid from net earnings in two years.

39.

The landlords contend that the appointment of the Trustee in this Chapter X proceeding was a breach of the lease and that such breach was a forfeiture of the term. The lease provides, in Paragraph 12, as follows:

> "This lease shall be terminated by any act of the Tenant, the result of which would be to pass by operation of law, or otherwise, any interest or estate in the leased premises to any Trustee or Receiver in bankruptcy . . ." (Emphasis added)

This provision of the lease clearly indicates that in order for there to be a forfeiture it must be an act of the tenant. The petition filed herein was filed by three creditors of the tenant and not by the tenant itself. It is a well settled principle of both law and equity that contractual provisions for forfeiture are looked upon by the Courts with disfavor and are strictly construed against the parties seeking to invoke them. 49 Am. Jur. 2d., *Landlord & Tenant,* Section 1021.

In the North Carolina case of *Morris* v. *Austraw,* 269 N.C. 218, at Page 223 (1966), the Court quotes from 32 Am. Jur., *Landlord & Tenant,* Section 848, as follows:

> "Generally, unless there is an express stipulation for a forfeiture, the breach of a covenant in a lease does not work a forfeiture of the term. Moreover, the settled principle of both law and equity that contractual provisions for forfeitures are looked upon with disfavor applies with full force to stipulations for forfeitures found in leases; such stipulations are not looked upon with favor by the court, but on the contrary are strictly construed against the party seeking to invoke them. As has been said, the right to declare a forfeiture of a lease must be distinctly reserved; the proof of the happening of the event on which the right is to be exercised must be clear; the party entitled to do so must exercise his right promptly; and the result of enforcing the forfeiture must not be unconscionable."

In the case of *Thompson* v. *Christie,* 138 Pa. 230, 20 A. 934 (1890), there are listed four requirements to be fulfilled before forfeiture by the landlord may be required:

(1) The right to declare a forfeiture must be distinctly reserved;
(2) The proof of the happening of the event on which the right is to be exercised must be clear;
(3) The party entitled to do so must exercise his right promptly; and
(4) The result of enforcing the forfeiture must not be unconscionable.

It has been universally held that forfeiture clauses in leases are to be liberally construed in favor of the lessee. *Smith* v. *Hoboken R. Co.,* 328 U.S. 123 (1946) and *Brazeal* v. *Bokolman,* 8th Cir., 270 F.2d 943 (1959).

In *Galvin* v. *Southern Hotel Corp.,* 4th Cir., 154 F.2d 970, Judge Soper stated, in referring to a forfeiture clause in a lease:

> "... it is the settled principle of both law and equity that contractual provisions for forfeiture are looked upon with disfavor, and will not be enforced if the result of a forfeiture will be unconscionable."

In strictly construing Paragraph 12 of the lease, it is evident that the parties contracted for any act of the tenant. The instituting of this Chapter X proceeding was not an act of the tenant, but was rather an act of the creditors, who brought this proceeding to protect their claims, and this action is not a breach of the covenant in the lease for which a forfeiture may be declared.

40.

The landlords are relying principally upon *Finn* v. *Meighan,* 325 U.S. 300, 65 S. Ct. 1147 (1945), and they would have this Court apply the provisions of Section 70B of the Bankruptcy Act (11 U.S.C. 110) blindly to any and every lease of property immediately upon default by the lessee. Section 70B of the Act reads:

> ". . . but an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto, or of either party, shall terminate the lease or give the other party an election to terminate the same shall be enforceable."

It is true that the applicability of Section 70B to reorganization proceedings under Chapter X make a covenant like the one in the case at bar enforceable in such proceedings. But less than one year following its decision in *Finn*, the Court made it clear that the question of the enforceability of such a covenant is separate and distinct from the question of whether enforcement in a particular case would be consistent with other provisions of the Bankruptcy Act. *Smith* v. *Hoboken, supra.* In *Smith*, the Court ruled that because of the great public interest, represented there by the Interstate Commerce Commission, in the forfeiture of a lease of a railroad line and because forfeiture would preclude the formulation of any plan of reorganization, that the lease should not be forfeited.

In the instant case, if forfeiture of the lease is now declared, no plan of reorganization may be possible in that the hotel and its furnishings erected on the leased premises are the only asset of the tenant.

41.

The rationale of *Smith* v. *Hoboken, supra,* was held controlling in a Chapter X case that is definitely on "all-fours" with the instant case. *In re Fleetwood Motel Corp.*, 3rd Cir., 335 F.2d 857 (1964). In that case the debtor, like the debtor here, built a motel on land that it had leased from others. Like this debtor-lessee, that debtor-lessee financed construction by selling securities to the public. There, as here, the publicly held debtor encountered financial difficulties which prevented it from meeting its obligations under the lease and petitioned for corporate reorganization. As in this case, the landlord there sought to terminate the Chapter X debtor's leasehold by invoking the forfeiture clause. In that case the landlord's petition for possession was denied, the Court saying:

"When you are dealing with the rights of creditors in what you might term a bankrupt estate, when you are dealing with stockholders to the extent we have in this case with the Securities and Exchange Commission supervising their rights, it seems to this Court that, sitting as a court of equity, it would be unconscionable to allow repossession here. It would constitute in the law a forfeiture."

The instant case is actually much stronger for disallowance of a forfeiture than *In Re Fleetwood Motel Corp.*, supra, in that in the *Fleetwood* case the tenant failed to pay the rental of $40,000.00 when the same became due and failed to pay $26,000.00, plus interest on the mortgage which had to be paid by the landlords, and failed to pay the ad valorem taxes in the amount of $8,130.68. Here, all the mortgage payments were paid by the tenant and the Trustee has continued to pay the same monthly since his appointment. All of the rental has been paid to the landlords, including payment of the basic annual rental in advance through April 30, 1971. In addition, the ad valorem taxes due the local authorities have been paid to date. The Trustee has done an excellent job in the operation of the hotel on the leased premises and is in a very favorable position to effectuate an acceptable plan of reorganization. The corporation is making money under the guidance of the Trustee, and the unfavorable management situation has been completely cleared up and the landlords are now happy with the management and operation of the hotel. The landlords have not been hurt in any way and the operation of the hotel by the Trustee has proven to them that they can make more money than they anticipated originally under the terms of the lease. All of the defaults complained of by the landlords have already been cured, including the selection of an accountant satisfactory to the landlords. To allow a landlord who owned property which originally cost him approximately $3,100.00, and was worth $150,000.00 at the time of the hearing of this matter, to possession of a hotel which was built and equipped by the

tenant and which is now worth $2,000,000.00, with forty-six (46) years remaining on the lease, would constitute a windfall of some $990,267.91 on February 18, 1970, and now well over $1,000,000.00, at the expense of the creditors, stockholders, and debenture holders. This would be grossly inequitable, unconscionable, unjust, and shock the conscience of this Court.

42.

There is one major distinguishing factor which has caused the Courts to apply their inherent power of equity. Where the landlord built the improvements on the land and the lessee goes bankrupt, the Courts have not hesitated in upholding a forfeiture. However, where the tenant is largely responsible for the improvements, the Courts in Chapter X reorganization proceedings have not allowed the landlord to gain a windfall and have refused the relief on equitable principles.

The purpose of any reorganization proceeding is the ultimate rehabilitation of the debtor and to allow a forfeiture here, before a plan of reorganization has been presented, would be inequitable, unjust and grossly unconscionable.

WHEREFORE, IT IS ORDERED, ADJUDGED AND DECREED:

A. The petition of Coy L. Weaver and wife, Helen F. Weaver, for the return of the leasehold estate and possession be and the same is hereby denied.

B. The Trustee have and recover of Coy L. Weaver and wife, Helen F. Weaver, the sum of $1,139.75, which is the actual cost of the Court Reporter in transcribing the testimony in this hearing on this claim and the witness fees and witness expenses as actually paid by the Trustee.

Dated at Greensboro, North Carolina, in said District, on the 31 day of July, 1970.

/s/ Rufus W. Reynolds
Referee in Bankruptcy

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA DURHAM DIVISION

IN THE MATTER OF
LANDMARK INNS OF DURHAM, INC.,
DEBTOR

No. B-198-69

Order

Coy L. Weaver and his wife Helen F. Weaver, landlords of the debtor corporation have petitioned for a review of the findings of fact, conclusions of law, and order entered by the Honorable Rufus Reynolds, Referee in Bankruptcy, on July 31, 1970. In his order the Referee denied the landlord's petition for a forfeiture of the leasehold estate on the grounds, *inter alia,* that a forfeiture under these circumstances would be "inequitable, unjust, and grossly unconscionable."

After hearing oral arguments and carefully considering transcripts, exhibits and briefs of counsel—including that of the Securities and Exchange Commission—it is found that the findings of fact and conclusions of law of the Referee are neither arbitrary nor clearly erroneous.

Accordingly, it is ORDERED, ADJUDGED AND DECREED that:

(a) the findings of fact and conclusions of law entered by the Referee on July 31, 1970, be, and the same hereby are, affirmed; and

(b) the motion of the landlords for reversal should be, and hereby is, denied.

/s/ Eugene A. Gordon
United States District Judge

March 4, 1971

APPENDIX C

IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA DURHAM DIVISION

IN THE MATTER OF
LANDMARK INNS OF DURHAM, INC.
DEBTOR

No. B-198-69

Order

On March 4, 1971, an Order was entered in this matter affirming the Findings of Fact and Conclusions of Law of the Referee.

The attorney for the Landlords has filed a motion pursuant to Rule 52(b) of the Federal Rules of Civil Procedure seeking to amend portions of the Order. After reconsidering the transcripts, exhibits and briefs of counsel, it is specifically found that Paragraph 23 and Paragraph 39 of the Referee's Findings of Fact and Conclusions of Law are neither arbitrary nor clearly erroneous.

For this reason, it is ORDERED, ADJUDGED AND DECREED that the motion of the Landlords pursuant to Rule 52(b) be and the same hereby is denied.

/s/ Eugene A. Gordon

March 16, 1971

United States District Judge

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 71-1577

COY L. WEAVER AND HELEN F. WEAVER,

Appellants,

v.

RICHARD M. HUTSON, II, TRUSTEE OF LANDMARK INNS OF DURHAM, INC.,

Appellee.

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro. Eugene A. Gordon, District Judge.

(Argued January 6, 1972 Decided February 28, 1972.)

Before Bryan, Winter and Russell, Circuit Judges.

Charles B. Nye (Nye and Mitchell on brief) for Appellants, and William R. Winders (Winders, Williams, and Darsie on brief) for Appellee. Allston J. Stubbs (Stubbs, Biggs and Cole on brief) for Debtor, Appellee. Paul Gonson, Assistant General Counsel, Securities and Exchange Commission, (David Ferber, Solicitor, Michael E. Don, Attorney, Securities and Exchange Commission, on brief) for the Appellee, Securities and Exchange Commission.

PER CURIAM:

A creditors' petition under Chapter X of the Bankruptcy Act, II USC 501 et seq., was filed on September 3, 1969 by three debenture holders of Landmark Inns of Durham, Inc., a North Carolina corporation (Debtor). The petition was approved on September 12, 1969 and a trustee thereupon appointed by the District Court.

Among its assets Debtor held a lease dated March 27, 1964, for a term of 52 years upon the property of Coy L. Weaver and his wife, Helen F. (Landlords). The land had

been acquired by Landlords in 1942 for $3100 and, at commencement of the bankruptcy hearing, was valued at $150,000 without improvements. As envisioned in the lease, Debtor constructed and operated a motor hotel on the premises, the total appraised value of which, including land, fixtures, equipment and furniture, is approximately $2,000,000. Under the lease a minimum annual rental of $19,159 was payable in advance, with an additional year-end payment based upon a specified percentage of the gross income or net profit for the year.

Of the estimated initial construction cost of $925,000, $730,000 was obtained through a first mortgage made possible by Landlords' subordination of their reversion. The actual cost considerably exceeded the initial estimate, and in 1966 Debtors, lacking sufficient funds to complete the project, requested Landlords to join Debtor in procuring a second mortgage of $110,000. Thereafter, Landlords and Debtor executed a second deed of trust securing a note in that amount with a maturity date of September 1968.

In 1968 Debtor asked Landlords to subordinate their interest to yet another deed of trust, this one to be in the sum of $437,500. The request was declined by Landlords, and, after Debtor failed to pay the $110,000 second trust at maturity, Landlords, by letter dated November 18, 1969, notified Debtor of numerous breaches of the lease as well as the default in the second trust. In May of 1969 this obligation was purchased from the holder by the five major stockholders of Debtor.

Finally, after continually ignored warnings of both the numerous breaches and the delinquent second trust, on August 15, 1969 Landlords demanded immediate possession of the premises. Ten days later Landlords commenced an ejectment action in the appropriate State court and trial was set for September 3, 1969. Before the hearing the major stockholders, who had purchased the second trust, attempted to persuade Landlords to withdraw the eviction proceedings, offering in return to wait six months before foreclosing. Landlords refused. Three of these stockholders on September 2, the day before the ejectment action was to

be heard, demanded payment of certain past due interest on the debentures held by them. Next day, simultaneously with the start of the State court trial, the three filed the Chapter X petition as creditors by virtue of their debenture holdings. The eviction proceeding was thereupon held in abeyance.

Landlords then petitioned the District Court to declare the lease forfeited because of the alleged breaches, particularly the institution of bankruptcy proceedings under pain of the sanctions of paragraph 12 of the lease:

> "This lease shall be terminated by any act of the Tenant, the result of which would be to pass by operation of law, or otherwise, any interest of estate in the leased premises to any Trustee or Receiver in bankruptcy. . . ."

Landlords maintained, both in the District Court and here, that the filing of the Chapter X petition by the three debenture holders, who were also major stockholders and quite active in company affairs, was in fact an "act of the Tenant" under paragraph 12. Further, as justifying forfeiture, Landlords point to Debtor's tardiness in paying rent and percentages, the employment of auditors not of Landlords' choosing, and several other lease violations arising from corporate mismanagement.

The cause, with the Landlords' petition to the District Court, was duly committed to the Referee in Bankruptcy. He found that Landlords had accepted basic rentals covering periods of tenancy following the breaches. He concluded that by acceptance of those rentals, which had been computed by auditors employed by Debtor, and by withholding objection to the auditors until after receipt of these payments, Landlords had waived any claim to termination for delays in payments or Debtor's selection of auditors.

He determined, too, that Landlords had failed to establish a breach under the forfeiture clause of the lease (paragraph 12). In the first place, he was of the opinion that it had not been violated because the recourse to Chapter X had not been an "act of the Tenant," but rather the act of the creditors. It is not necessary to discuss this conclusion,

however, since the same result came about through another conclusion of the Referee. He said to permit Landlords to enforce a forfeiture would be grossly inequitable in view of all the circumstances, especially Landlords' acceptance of rents for Debtor's occupancy after invocation of paragraph 12.

Summarized, the bases of his refusal of forfeiture were: that all rentals and percentages have been satisfied; that, through the bankruptcy trustee's assurance, Landlords have been relieved of any duty to pay the second trust of $110,000; that under the guidance of the trustee the motel is in successful operation; that Landlords' financial interests are not in jeopardy; that, as feared by the Securities and Exchange Commission, intervenor, a forfeiture would cause complete loss to Debtor's creditors, stockholders and debenture holders; and, finally, that forfeiture would prove a windfall of about $1,000,000 for Landlords.

We have evaluated the Referee's findings and conclusions and are of the opinion that the District Court was right in adopting them, and affirming the decision of the Referee.

In holding the reception of post-accruing rents to be a waiver of lease violations, committed prior to the acceptance of the rents, the Referee is backed by the decisional law of North Carolina. Thus the lesson of Fairchild Realty Company v. Spiegel, Inc., 246 NC 458, 98 SE2d 871 (1957) is:

> " 'It is the generally accepted rule that if the landlord receive rent from his tenant, after full notice or knowledge of a breach of a covenant or condition in his lease, for which a forfeiture might have been declared, such constitutes a waiver of the forfeiture which may not afterwards be asserted for that particular breach, or any other breach which occurred prior to the acceptance of the rent.' " Id. at —, 98 SE2d at 877, *quoting* Winder v. Martin, 183 NC 410, —, 111 SE 708, 709 (1922).

This same principle bars forfeiture under a lease provision terminating the demise if the tenant procures the appoint-

ment of a trustee under the Bankruptcy Act, BJM Realty Corp. v. Ruggieri, 326 F2d 281, 282-83 (2 Cir. 1964).

Section 70(b) of the Bankruptcy Act, 11 USC 110(b), provides that "an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable." While Finn v. Meighan, 325 US 300 (1945), declared the quoted section applicable to Chapter X proceedings, shortly thereafter Smith v. Hoboken RR, etc. Company, 328 US 123 (1946), announced that a forfeiture clause was to be applied with an eye to its effect on the proposed reorganization plan, there a railroad under § 77 of the Bankruptcy Act, 11 USC 205. The Court, at 131-32, stayed effectuation of the clause, saying:

> "Moreover, it appears in the present case that forfeiture of the lease will deprive the debtor of all of its railroad properties. Whether a particular carrier should go out of business presents problems of primary importance to its security holders and perhaps to the public interest as well. If forfeiture of the lease is now declared, no plan of reorganization may be possible."

Refusal to allow forfeiture, although the lease contained a proviso therefor, was upheld by In re Fleetwood Motel Corporation, 335 F2d 857 (3 Cir. 1964), on facts strikingly like those here. That opinion fully discusses § 70(b), supra, 11 USC 110(b), its applicability to Chapter X proceedings and its nurture by Finn v. Meighan, supra, 325 US 300 (1945), as well as by Smith v. Hoboken RR, etc. Company, supra, 328 US 123 (1946). Particularly instructive is this statement of the Court from *Fleetwood*:

> "We think that the rationale of Smith, coupled with the inherent equity powers of a court of bankruptcy, see McDonnell v. Bucks County Farms, Inc., 334 F.2d 763, 766 (C.A.3, 1964), provide abundant support for the conclusion of the district court in the case at bar.

For here the public, represented by the Securities and Exchange Commission, has invested over a half million dollars in the debtor corporation. And obviously no plan of reorganization could be formulated if forfeiture were permitted, for the property which the landlord would obtain by such action is the only property of the debtor. . . . Suffice it to say that they [the facts] amply warranted the exercise of the equitable power of the bankruptcy court to deny the landlord's petition for possession of the premises." 335 F2d at 862.

Notably, both *Smith* and *Fleetwood* accent that the result of the forfeiture there sought would be the complete emasculation of the reorganization because the forfeiture would remove the entire res from the estate of the debtor. This would be precisely the effect of a forfeiture in the case at bar. The reorganization would become wholly moot, since the sole property of Debtor would revert to Landlords.

The order of the District Court refusing Landlords' petition for forfeiture is affirmed.

Affirmed.

APPENDIX E

IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
NO. 71-1577

COY L. WEAVER AND WIFE, HELEN F. WEAVER,

Appellants

VERSUS

RICHARD M. HUTSON, II., TRUSTEE OF LANDMARK INNS OF DURHAM, INC.

Appellee

IN THE MATTER OF:

LANDMARK INNS OF DURHAM, INC.,

Debtor

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO.

PETITION FOR REHEARING
(Landlords)

In the Court's opinion, which was decided on February 28, 1972, it overlooked or misapprehended certain facts concerning the acceptance of rents "after invocation of Paragraph 12." (Pp. 5-7) Additionally, the Court holds that the acceptance of the rents after invocation of Paragraph 12 bars forfeiture under a lease provision to terminate the demise if the tenant procures the appointment of a Trustee under the Bankrutcy Act. (P 7) In connection with the foregoing, the attorney for the Landlords, the attorney for the Trustee, and the Trustee entered into written Stipulations prior to the payment of any rent by the Trustee after the invocation of Paragraph 12. The Stipulations read in part as follows:

> "2. The payment by the Trustee is without prejudice to either party in the pending action and neither party waives any rights as a result of the receipt or

payment of the said rent, and the acceptance of the rent by the Landlords cannot be utilized by the Trustee as a defense to the action at any stage. (Emphasis Added)

"3. In the event that the Landlords recover the property as a result of their Petition prior to April 30, 1971, the Landlords will refund to the Trustee the prorata share of the unused annual rental which has been paid in advance this date.

"4. It is stipulated and agreed that the Referee in Bankruptcy may find as a fact in this proceeding that the said rental was paid by the Trustee but without prejudice to either party." (Emphasis Added)

The Stipulations were approved by the Referee and no rental was ever received after the invocation of Paragraph 12 without the benefit of the Stipulations and without the Landlords complete reliance thereon.

The Landlords entered into these Stipulations so that they would not be prejudiced by the acceptance of the rentals from the Trustee in connection with the invocation of Paragraph 12. The Landlords' attorney was well aware of the legal implications of accepting rent from the Trustee without the benefit of the Stipulations.

The Trustee apparently entered into the Stipulations because of the benefits to be derived under Paragraph 3 of the Stipulations in the event the Landlords prevailed.

The Referee approved the Stipulations but reserved the right to discuss the rental paid by the Trustee apparently as evidence of the ability of the Trustee to reorganize the Debtor.

The Referee's Findings and Conclusions are somewhat confusing concerning the payment of rentals; however, a review of Paragraphs 34 through 37 of his Conclusions of Law (App. pp 60-64) will show that he was distinguishing between the rentals paid by the Tenant and the rentals paid by the Trustee when he declares that the Landlords are not entitled to a forfeiture. For example, the first sentence of Paragraph 34 (App. p 60) states: "The Landlords are not

entitled to a forfeiture of the lease for failure of the Tenant to pay rent." (Emphasis Added) Under Paragraph 37 (App. p 64), he states: "The Landlords went much further in waiving the objections to the accountants by acceptance of the overage in the amount of $4,634.55, based on figures prepared by Harris, Kerr, Forster & Company. This acceptance constituted a complete and absolute waiver and the Landlords are now estopped to claim such a breach." The Four Thousand Six Hundred Thirty-Four & 55/100 ($4,634.55) Dollars was paid by the Tenant prior to the bankruptcy proceedings.

In each case, when the Referee was referring to an estoppel or waiver, he was referring to the payment of rentals made by the Tenant prior to the institution of the proceedings in bankruptcy since the Landlords were also asking for forfeiture for breaches prior to the invocation of Paragraph 12 as well as for the invocation of Paragraph 12.

In view of the Stipulations, no attorney opposing the Landlords' position did argue or can argue that there was a waiver after the invocation of Paragraph 12 and that the acceptance of the rental from the Trustee bars forfeiture under the lease provisions terminating the demise if the Tenant procures the appointment of a Trustee under the Bankruptcy Act.

In the last sentence of Paragraph 16 on Page 46 of the Appendix, the Referee recognized that "these payments were received by Charles B. Nye, attorney for the Landlords, with the consent stipulation that it was without prejudice." These payments that the Referee referred to were the payments made by the Trustee after the invocation of Paragraph 12.

What is the effect of the Stipulation made in favor of the Landlords? Turning to the authorities, we first observe the following general discussion of a stipulation in 50 Am. Jur., Stipulations:

> (Section 4, P. 607) ". . . . As a general rule, stipulations should receive a fair and liberal construction,

in harmony with the apparent intention of the parties and the spirit of justice, and in the furtherance of fair trials upon the merits rather than a narrow and and technical one calculated to defeat the purposes of their execution. (Section 8, P. 609). . . . In all cases of doubt, that construction should be adopted which is favorable to the party in whose favor it is made. (Section 8, P. 609) . . . Subject to the conditions and limitations respecting the subject matter and in compliance with statutory requisites or rules of court, and to rights in respect of withdrawal or relief, stipulations made by parties to a judicial proceeding, or by their attorneys, within the scope of their authority, are binding upon those whom they lawfully represent, and also upon the trial and appellate courts, in the absence of any valid ground or reason for refusing enforcement." (Emphasis Added)

Courts are generally bound by and must enforce stipulations regarding matters which may validly be made the subject of stipulations. 83 C.J.S., Stipulations, Section 17; *Moore v. Humphrey*, 247 N.C. 423, 101 S.E. 2d 460 (1958).

The Federal cases are no less decisive on this point. See, for example, *Schley v. Pullman Car Co.*, 120 U.S. 575, 7 Sup. Ct. 730, 30 L. Ed. 789 (1887) (stipulation binding and limits case on appeal); *New York, L.E. & W.R. Co. v. Estill*, 147 U.S. 591, 13 Sup. Ct. 444, 37 L. Ed. 292 (1893) (where the parties agreed that damages to cattle were to be based on the value of cattle at their ultimate destination, the defendant could not contend on appeal that the true basis of damages was the value of the cattle as they were delivered at the terminus of its road). See also *Hankinson v. Pa. R.R. Co.*, 280 F. 2d 249 (3rd Cir., 1960). Other cases include *Connell Bros. Co. v. H. Diederichsen & Co.*, 213 Fed. 737 (9th Cir., 1914), and *Coty, Inc. v. Prestonettes, Inc.*, 3 F. 2d 984 (2nd Cir., 1924) (issue of unfair competition held removed from case due to stipulation).

It is very true that the Trustee has made all payments as and when due; however, it is also very true that no pay-

ment has ever been made by the Trustee or received by the Landlords without the stipulation that the same was made and received without prejudice.

Since the Landlords cannot be prejudiced by the acceptance of the rents from the Trustee after the invocation of Paragraph 12 because of the Stipulations now brought to the attention of the Honorable Court, the Landlords sincerely request for the Court to find as a fact and as a matter of law that the proceedings below were instituted as a result of an "act of the Tenant" based on either or both of the following:

1. That the fact that Debtor filed an answer to the "Creditors' Petition" admitting all of the material allegations of the Petition resulted in an act of bankruptcy. See Judge Stanley's Order (App. p 12) where he found that the answer filed by the Debtor corporation did not materially controvert any allegation of the Petition. Additionally, the Debtor's answer is in the Court's records. As a matter of law, the filing of the Answer, itself, constituted an act of bankruptcy under the authorities cited on Pages 17 through 19 of the Apellants' Brief.

2. That the "creditors" were acting for and on behalf of the Debtor or its alter ego when they filed the Petition. Otherwise, the Creditors' Petition was and is a sham and a fraud upon the Court and the Landlords. As a matter of law and equity, the acts of the "petitioning creditors" were "acts of the Tenant" for the reasons set forth on Pages 19 through 26 of the Appellants' Brief.

It is earnestly submitted that the receipt of the rents from the Trustee cannot and must not prejudice the Landlords in view of the written Stipulations, as approved by the Referee. It is further earnestly submitted that the Court should find that the Debtor committed an act of bankruptcy, in violation of Paragraph 12 of the lease, even if the Court were then to conclude as a matter of equity that such breach of Paragraph 12 did not result in a forfeiture. Perhaps all parties have heretofore furnished the Court with too much "background music." The sole issues before the Court should have been whether or not there was an act of bankruptcy and the consequences thereof.

Conclusion

The Landlords respectfully conclude and submit that a rehearing should be held to determine whether or not the Landlords waived the provisions of Paragraph 12 of the lease by accepting rentals from the Trustee in view of the Stipulations entered into by and between the parties. Further, the Landlords respectfully conclude and submit that if they are not to be prejudiced by the acceptance of the rentals from the Trustee, then and in that event, the rehearing should also determine whether or not the Debtor committed an act of bankruptcy and whether or not the same would result in a forfeiture. The latter question is extremely important in determining the equitable powers of the Bankruptcy Courts in the Fourth Circuit as they pertain to Section 70 (b) of the Bankruptcy Act.

Respectfully submitted,

/s/ CHARLES B. NYE
Nye & Mitchell
P. O. Box 1131
Durham, North Carolina 27702
(919) 682-6191

Certificate of Service

THIS IS TO CERTIFY that I have this date served two (2) copies of the foregoing Petition for Rehearing on each of the attorneys of record listed by mailing same to them by United States Mail, postage prepaid, to their respective office addresses, as follows: Mr. Paul Gonson, Assistant General Counsel, Securities and Exchange Commission, Washington, D. C. 20549, Mr. Allston J. Stubbs, attorney for the Debtor, Home Savings & Loan Building, Durham, North Carolina 27701, Mr. Richard Hutson, II., Trustee, 102 East Main Street, Durham, North Carolina 27701, and Mr. William R. Winders, attorney for the Trustee, First Federal Savings & Loan Building, Durham, North Carolina 27701.

This the 10th day of March, 1972.

/s/ CHARLES B. NYE
Attorney for Appellants

APPENDIX F

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 71-1577

COY L. WEAVER AND HELEN F. WEAVER,

Appellants,

v.

RICHARD M. HUTSON, II, TRUSTEE OF LANDMARK INNS OF DURHAM, INC.,

Appellee.

Order Denying Petition for Rehearing

By petition for rehearing, appellants Weaver, Landlords, assert that this court denied their claim for forfeiture of the lease because by accepting rents accruing after Landlords' notification of termination under Paragraph 12, Landlords had waived their option to terminate it. The decision is erroneous, Landlords continue, because the bankruptcy trustee had stipulated with them that such acceptance of rents would be without prejudice to their case.

The answer is that neither the Referee, nor the District Court, nor this court refused forfeiture of the lease because of such acceptance. The fundamental bases of decision throughout was that the Landlords' insistence upon a forfeiture was highly unconscionable and inequitable in the circumstances—a demand for blood. The conclusion generally was that as a court of equity the bankruptcy court had the discretion and power to refuse enforcement of Paragraph 12, and rightfully exercised this prerogative. Fleetwood Motel Corporation, 335 F2d 857, 862 (3 Cir. 1964) cited in the opinion in the instant case. Furthermore, we declined forfeiture in the circumstances as defeating the reorganization aims of Chapter X.

The petition for rehearing is denied. At the request of the Securities and Exchange Commission we correct the reference to the Commission as an "intervenor," and substitute therefor the word "appellee."

For the Court:

/s/ Albert V. Bryan
United States Circuit Judge

Dated March 31, 1972

In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1645

COY L. WEAVER and HELEN F. WEAVER, PETITIONERS

v.

RICHARD M. HUTSON, II., TRUSTEE OF LANDMARK INNS OF DURHAM, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION [1]

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 34a) is not yet officially reported. There is no opinion of the district court (Pet. App. 32a-33a); the

[1] The Securities and Exchange Commission has been participating in this reorganization proceeding in the district court as a party pursuant to Section 208 of Chapter X of the Bankruptcy Act, 11 U.S.C. 608, since shortly after the commencement of the proceeding in 1969, and has taken positions in the district court and in the court of appeals similar to those expressed in this brief. As in *Protective Committee* v. *Anderson*, 390 U.S. 414, 420, n. 3, and *Caplin* v. *Marine Midland Grace Trust Co.*, No. 70-220, decided May 22, 1972, the Commission is "an unnamed respondent before this Court." See Rule 21(4) of the Rules of this Court.

"Findings of Fact, Conclusions of Law, and Order" of the Referee in Bankruptcy (Pet. App. 1a) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on February 28, 1972 (Pet. App. 34a), and a petition for rehearing (Pet. App. 40a) was denied on March 31, 1972 (Pet. App. 46a). The petition for a writ of certiorari was filed on June 19, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). See also 11 U.S.C. 47(c).

QUESTION PRESENTED

Whether, in the circumstances of this reorganization proceeding under Chapter X of the Bankruptcy Act, the referee in bankruptcy properly refused to enforce a forfeiture provision in a lease covering land upon which a hotel—the only asset of the corporation undergoing reorganization — had been constructed.

STATEMENT

The proceeding for the reorganization of Landmark Inns of Durham, Inc. ("debtor") under Chapter X of the Bankruptcy Act, 11 U.S.C. 501 *et seq.*, was commenced on September 3, 1969, by the filing of an involuntary petition against the debtor. The debtor consented to the petition shortly thereafter, and on September 12, 1969, the petition was approved and the respondent was appointed trustee (Pet. App. 16a, 34a).

The debtor's only asset of consequence is an eight-story motor hotel which it owns and operates (Pet. App. 5a, 18a, 29a). Opened for business in the summer of 1966 (Pet. App. 6a), the hotel was built and equipped by the debtor at a cost of about $1,500,000 (Pet. App. 6a, 19a). Of this, about $700,000 was supplied by public investors who purchased stock and debentures of the debtor (Pet. App. 4a, 20a).

The hotel was constructed on land leased to the debtor by petitioner in 1964 for a term of 52 years (Pet. App. 2a). The land had been acquired by the petitioners in 1942 for about $3,100 and is now worth about $150,000 (Pet. App. 1a, 19a, 35a). Petitioners have made no financial investment in the hotel.

The lease provided for termination upon "any act of the Tenant, the result of which would be to pass by operation of law, or otherwise, any interest or estate in the leased premises to any Trustee or Receiver in bankruptcy * * *" (Pet. App. 2a-3a, 36a). Contending that the filing of the involuntary Chapter X petition by three creditors (who were also major stockholders and active in the affairs of the debtor) (Pet. App. 16a, 36a) was an "act of the tenant" within the meaning of the lease, and asserting other alleged defaults under the lease,[2] petitioners asked the district court to declare the lease

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[2] Petitioners apparently now concede that the district court properly refused to grant a forfeiture based upon breaches of the lease other than the "breach pertaining to the institution of the Chapter X proceedings" (Pet. 6).

forfeited and to give them possession of the land and the hotel (Pet. App. 1a, 36a).

The referee in bankruptcy, to whom the proceeding was transferred by the district court (Pet. App. 21a-22a), found that all of the defaults under the lease had been cured (Pet. App. 20a, 30a) and that petitioners had been paid their rental to date (Pet. App. 30a). The referee also found that the petitioners had not been harmed by the breaches (Pet. App. 21a, 30a), that they would make more money under the operation of the hotel by the trustee than they had anticipated originally under the lease[3] (Pet. App. 30a), and that petitioners were satisfied with the trustee's management and the amount of the rental they were receiving (Pet. App. 19a). The referee further found that the fair market value of the hotel on a going concern as well as on a replacement cost basis was about $2,000,000 (Pet. App. 6a, 17a, 19a) and that the secured debt aggregated about $1,000,000 (Pet. App. 18a), so that to have permitted a forfeiture of the hotel built and equipped by the debtor, with 46 years remaining on the lease, would have constituted a windfall to the petitioners of "over $1,000,000 at the expense of the creditors, stockholders, and debenture holders" of the debtor (Pet. App. 30a-31a). The referee found that such a windfall "* * * would be grossly inequitable, unconscion-

[3] The lease is a "percentage lease" and the rental is based in part on the gross receipts (Pet. App. 2a, 35a), which had increased during the operation by the trustee (Pet. App. 15a, 17a).

able, unjust, and shock the conscience of this Court" (Pet. App. 31a).

The referee found, moreover, that if the lease were forfeited, the reorganization proceeding would be aborted since the only assets of the debtor were the hotel and the equipment and furnishings located therein (Pet. App. 18a, 29a); as a result, the creditors and stockholders would lose their entire claims totaling $878,530 (Pet. App. 21a), notwithstanding that the operation of the hotel by the trustee had been quite successful (Pet. App. 17a, 20a, 30a).

On review, the district court affirmed the findings of fact and conclusions of law of the referee and the denial of the forfeiture (Pet. App. 32a, 33a) and the court of appeals affirmed (Pet. App. 34a, 37a). In its order denying the petition for rehearing (Pet. App. 46a), the court of appeals noted that it had refused forfeiture of the lease because petitioners' insistence upon the forfeiture was, under the circumstances, highly unconscionable and inequitable—"a demand for blood"—and because a forfeiture would have defeated the reorganization aims of Chapter X. The court of appeals concluded "that as a court of equity the bankruptcy court had the discretion and power to refuse enforcement of * * * [the forfeiture clause in the lease] and rightfully exercised this prerogative" (*ibid.*).

ARGUMENT

The decision of the court of appeals, which rests on the rationale of this Court's decision in *Smith* v. *Hoboken R. Co.*, 328 U.S. 123, and follows the decision of the Third Circuit in *In re Fleetwood Motel*

Corporation, 335 F. 2d 857, is correct and presents no issue warranting review by this Court. Contrary to petitioners' assertions (Pet. 9), the decisions in the instant and *Fleetwood* cases are not in conflict with the decisions of this Court or any other court.

1. The portion of Section 70(b) of the Bankruptcy Act, 11 U.S.C. 110(b), which provides that "an express covenant that * * * the bankruptcy of a specified party [to a lease] * * * shall terminate the lease or give the other party an election to terminate the same is enforceable," was held by this Court in *Finn* v. *Meighan*, 325 U.S. 300, to be applicable to a reorganization proceeding under Chapter X of the Act since the forfeiture of a lease is not inherently inconsistent with the reorganization of a going business.[4] Less than a year after the *Finn* decision, the Court held in *Smith* v. *Hoboken R. Co.*, *supra*, that while the forfeiture provision of Section 70(b) is applicable to reorganization proceedings, whether a forfeiture provision should be enforced turns on the circumstances of the particular case. In *Smith*, a railroad reorganization proceeding under Section 77 of the Bankruptcy Act, the forfeiture clause was contained in a lease covering the major part of the assets of the debtor (328 U.S. at 124). This Court held that, under the circumstances, enforcement of

[4] Section 102 of Chapter X, 11 U.S.C. 502, provides that the provisions of the Bankruptcy Act relating to ordinary liquidating bankruptcy (which includes Section 70) are applicable to proceedings under Chapter X "insofar as they are not inconsistent or in conflict with the provisions" of that Chapter.

the forfeiture clause would be inappropriate since, among other reasons (328 U.S. at 132): "If forfeiture of the lease is now declared, no plan of reorganization may be possible." [5]

In *Fleetwood, supra*—a case strikingly similar to the instant case—the court of appeals relied on the rationale of *Smith* and the inherent equity powers of a bankruptcy court (335 F. 2d 862) and held that Section 70(b) did not require enforcement of a forfeiture clause in a lease where forfeiture would be inconsistent with the objectives of Chapter X.[6]

The arrangement here was essentially a security arrangement, designed to protect the lessor, and should be available to the lessor to protect him against loss. But courts of equity traditionally have refused to forfeit property interests to creditors for minor

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[5] While it is true that in *Smith*, as petitioners point out (Pet. 8), the forfeiture provision of the lease did not reflect the provisions of the Interstate Commerce Act requiring permission from the Interstate Commerce Commission for abandonment of railroad properties, the Court also noted that "[w]hether a particular carrier should go out of business presents problems of primary importance to its security holders * * *" (328 U.S. at 131-132). This statement is equally applicable to Chapter X proceedings.

[6] In *Fleetwood* the debtor, like the debtor here, built a motel on land it had leased from others with funds obtained from the sale of securities to the public. The court there denied the landlords' attempt to obtain possession, by invoking a forfeiture clause, on the grounds that it (1) would provide an unconscionable windfall to the landlords at the expense of public investors, who had invested over a half million dollars in the debtor, and (2) would abort the reorganization proceeding since the motel was the debtor's only asset.

breaches of financial arrangements that did not jeopardize the security, and particularly where forfeiture would give the creditor an unjustified windfall. For example, many mortgages on real property took the form of absolute conveyances of the land; the courts have not permitted the mortgagee to obtain the property as the result of a minor default by the mortgagor, such as a short delay in making regular payment, which did not prejudice the mortgagee. The defaults in the performance of the lease in this case have now been cured, and the operation of the motel by the trustee is more profitable to the lessor than its operation by the debtor. In these circumstances, the bankruptcy court, as a court of equity, properly refused to forfeit the lease—a forfeiture that would produce an unjustified windfall to the petitioners and was unnecessary to protect their security. Cf. *In re Pittsburgh Rys. Co.*, 155 F. 2d 477 (C.A. 3), certiorari denied, 329 U.S. 731.

2. Contrary to petitioners' assertions, there is no conflict among the circuits between the cases cited on pages 10 to 13 of the petition and the decision below or *Fleetwood*. Several of the cited cases involve liquidations in ordinary bankruptcy proceedings. Unlike ordinary bankruptcy, Chapter X seeks to conserve going-concern values and to foster reorganization. "The purpose of reorganization is to save a sick business, not to bury it and divide up its belongings" (*Susquehanna Chemical Corp.* v. *Producers Bank & Trust Co.*, 174 F. 2d 783, 787 (C.A. 3)). Hence, while enforcement of a forfeiture clause might thwart

that policy in a given reorganization proceeding, it could not do so in a bankruptcy liquidation. With one exception, the cases relied on which involve proceedings under Chapter X or Chapter XI of the Bankruptcy Act do not present equitable considerations of the type involved in the instant case or in *Fleetwood;* there is no indication, for example, that reorganization would be frustrated by a forfeiture, that the debtor had made any substantial investment on the leased premises or that the landlord would receive a windfall. In the one case where there were somewhat comparable equities to those here, *Friendly Center, Inc.* v. *Robinson*, 233 F. Supp. 274 (W.D. N.C.), the court, like the courts below, denied the landlord's request for forfeiture of a lease.

Petitioners recognize that if a forfeiture is not allowed in this case, "the [debtor] would most likely be in a position to reorganize with honest management, * * *" but they insist that they are entitled to a forefeiture "whether the demand is for blood or otherwise" (Pet. 10). We submit that the court of appeals correctly ruled that the bankruptcy court had discretion to refuse to order forfeiture.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

G. BRADFORD COOK,
General Counsel,

DAVID FERBER,
Solicitor,

PAUL GONSON,
Assistant General Counsel,
Securities and Exchange Commission.

AUGUST 1972.

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IN THE

Supreme Court of the United States

October Term, 1972

No. 71-1645

COY L. WEAVER AND HELEN F. WEAVER, Petitioners

v.

RICHARD M. HUTSON, II, TRUSTEE OF LANDMARK INNS OF DURHAM, INC., Respondent

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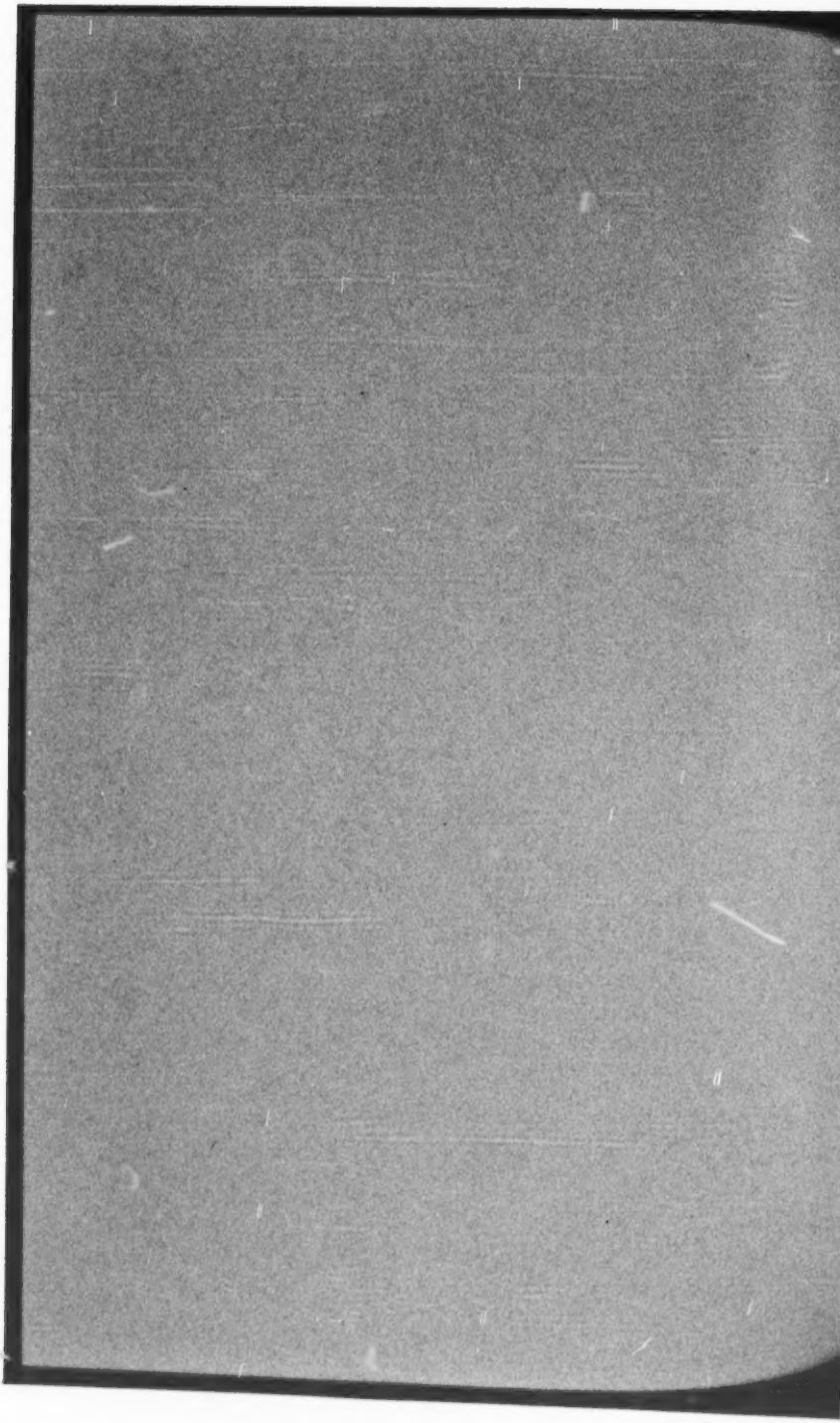
BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

William R. Winders
Winders, Williams & Darsie
Attorneys at Law
First Federal Building
Durham, North Carolina, 27701
Attorney for Trustee, Respondent

Allston J. Stubbs
Stubbs, Biggs & Cole
Attorneys at Law
Home Savings & Loan Building
Durham, North Carolina, 27702
Attorney for Debtor Corporation, Respondent



SUBJECT INDEX

Brief in Opposition to Petition

Argument 3

Citations to Opinions Below i

Conclusion 8

Questions Presented 1

Statement of the Case 1

CITATIONS

Cases:

Carson v. Imperial "400" National Inc., 267 N. C. 229, 147 S. E. 2d 898 (1966) 6, 7

Finn v. Meighan, 325 U. S. 300 (1945) 4

In Re Fleetwood Motel Corp., 3rd Cir., 335 F. 2d 857 (1964) 4

In Re Imperial "400" National, Inc., 3rd Cir. 429 F. 2d 680 (1970) 6

Morris v. Austraw, 269 N. C. 218, 152 S. E. 2d 155 (1969) 7

Smith v. Hoboken Railroad Co., 328 U. S. 123 (1946) 4, 7

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Question Presented

Whether the United States District Court, in proceeding under Chapter X of the Bankruptcy Act, properly exercised its equitable discretion in declining to enforce a forfeiture provision in a lease when such forfeiture would abort any successful reorganization attempt in the proceeding and result in a $1,000,000.00 windfall to the Landlords at the expense of creditors and public stockholders of the Debtor corporation?

Statement of the Case

This is a petition by the Landlords (Petitioners) of Landmark Inns of Durham, Inc., a corporation proceeding under Chapter X of the Bankruptcy Act, from a decision of the United States Court of Appeals for the Fourth Circuit, dated February 28, 1972, and an order denying a rehearing dated March 31, 1972. (Pet.App. 30a)

During 1964 the Debtor's predecessor entered into a 52-year lease agreement with the Petitioners. The leased premises is adjacent to the Veterans Administration Hospital in Durham, North Carolina, and approximately one-half mile from Duke University Medical

Center. The lease was later assigned to the Debtor corporation which caused to be constructed on the premises a modern motor hotel facility at a cost of $1,502,645.12. The building itself is eight stories high and contains 145 rooms and is built of reinforced concrete, steel and glass. It contains, in addition to the guest rooms, complete restaurant facilities, cocktail lounge, beauty shop, offices and three elevators. (Pet. App. 5a)

To finance the construction and initial cost, the Debtor corporation sold its common stock to 84 stockholders for the sum of $325,489.00 and in addition sold convertible debentures to 77 persons in the amount of $254,750.00 and sold non-convertible debentures to 14 persons in the sum of $100,500.00. The stock and debentures were purchased by individuals, including the original promoters and many citizens of the City of Durham. In addition to the sale of stock and debentures, capital was raised by permanent financing through Penn Mutual Life Insurance Company in the amount of $730,000.00 and a second mortgage in the amount of $110,000.00 to Chase Manhattan Bank. (Pet. App. 4a, 7a)

Because of financial difficulties, major creditors of the Debtor corporation filed a petition under Chapter X of the Bankruptcy Act, 11 U.S.C. 501 et seq., which was subsequently approved on September 12, 1969, and a Trustee was appointed by the District Court. (Pet. App. 16a, 17a)

The Landlords then petitioned the District Court to declare the lease forfeited because of certain breaches, all of which have been abandoned, except the breach because of institution of bankruptcy proceedings. The Landlords contend that because of the institution of bankruptcy proceedings, the lease is forfeited under paragraph 12, which provides:

> "This lease shall be terminated by any act of the Tenant, the result of which would be to pass by operation of law, or otherwise, any interest of estate in the leased premises to any Trustee or Receiver in bankruptcy. . . ."

At the time of the hearing of this matter in the District Court, the land owned by the Landlords was appraised for $150,000.00 and the motor hotel, constructed by the Debtor, was appraised for $1,955,000.00. The property is subject to a mortgage financing having a present balance of approximately $625,000.00 In the event that the Landlords would prevail in their forfeiture petition, they would take over the Debtor's only asset subject solely to the mortgage financing. This would result in a windfall of over $1,300,000.00 to the detriment of the trade creditors, debentureholders and stockholders having claims amounting to $878,530.60, plus interest. (Pet. App. 18a, 19a)

The operation of the hotel, under jurisdiction by the Trustee, has been very successful. All secured creditors and operating expenses are current and the Debtor corporation continues to show a profit and is in a position to be reorganized as soon as a determination in this cause is made. (Pet. App. 20a)

The Landlords have received in rental payments since the inception of the lease $117,083.05. The Trustee has paid a net rental to the Landlords of $26,584.58 in 1969-70 fiscal year and over $31,000.00 for 1970-71. (Pet. App. 20a)

The Referee In Bankruptcy, United States District Court and the United States Court of Appeals for the Fourth Circuit have all recognized the inherent equitable powers of the Courts under the Bankruptcy Act and steadfastly denied the Landlords relief.

Argument

The Petitioners contend that the Court of Appeals for the Third Circuit and Fourth Circuit have decided a Federal question concerning the enforceability of Section 70(b) of the Bankruptcy Act in conflict with the decisions of the Supreme Court of the United States. When one reviews these decisions, it is obvious that there is no conflict, and that the question of applicability and enforceability have always been separate and distinct.

In the case of *Finn v. Meighan,* 325 U. S. 300 (1945) this Court established that an express covenant in a lease provided for forfeiture of the leasehold interest was applicable to a proceeding under Chapter X of the Bankruptcy Act. The debtor in the *Finn* case was a large restaurant chain and this Court permitted the forfeiture of the one unit in question. The debtor in *Finn* neither had a substantial investment in the premises nor was it responsible for construction of the leasehold improvements and in addition had other restaurant units. In contrast, the Debtor in the case at bar has a $1,500,000.00 investment in leasehold improvements, a long term lease and a forfeiture of this lease would frustrate the entire reorganization proceeding.

Less than one year following the *Finn* decision, this Court made it clear in *Smith v. Hoboken,* 328 U. S. 123 (1946), that the question of the *enforceability* of a forfeiture covenant is separate and distinct from the question of whether enforcement in a particular case would be consistent with other provisions of the Bankruptcy Act. In *Smith,* the Court ruled that because of the public interest represented and because forfeiture would preclude the formulation of any plan of reorganization, that the lease should not be forfeited.

In the instant case, if forfeiture of the lease is now declared, no plan of reorganization may be possible in that the motel-hotel erected on the leased premises is the only asset of the Debtor corporation.

The rationale of *Smith v. Hoboken, supra,* was held controlling in a Chapter X case that is definitely on "all-fours" with the instant case. *In Re Fleetwood Motel Corp.,* 3rd Cir., 335 F. 2d 857 (1964). In that case, the debtor, like the Debtor here, built a motel on land that it had leased from others. Like this Debtor-Lessee, that debtor-lessee financed construction by selling securities to the public. There, as here, the publicly held debtor encountered financial difficulties and petitioned for corporate reorganization. The landlord then filed a petition to reclaim the premises on the basis that a forfeiture of the lease had occurred. The Court in refusing to allow such a forfeiture stated:

> "We think that the rationale of *Smith,* (Supreme Court Decision) coupled with the inherent equity powers of a Court of Bankruptcy, * * * provide abundant support for the conclusion of the District Court in the case at bar. * * * and obviously no plan of reorganization could be formulated if forfeiture were permitted, for the property which the landlord would obtain by such action is the only property of the debtor. * * * Suffice it to say they (factual circumstances) amply warranted the exercise of the equitable power of the Bankruptcy Court to deny the landlord's petition for possession of the premises." (Parenthesis added)

In the case at bar, the Landlords would receive a windfall of over $1,000,000.00 above outstanding encumbrances, and also, no plan of reorganization could be formulated if such were permitted.

To allow the Landlords, who owned property which originally cost them $3,100.00 and was worth $150,000.00 at the time of the hearing of this matter, to possession of a hotel which was built and equipped by the tenant and now worth $2,000,000.00 would constitute a windfall at the expense of the creditors, stockholders and debentureholders. This, we respectfully submit, would be grossly inequitable, unconscionable, unjust and shock the conscience of this Court.

The Petitioners cite many Federal decisions wherein the Court applied Section 70(b) of the Bankruptcy Act and enforced a forfeiture of the leased premises. These decisions are not at all in conflict with the holdings in the instant case; however, the question of enforcement is determined under each individual circumstance.

There is one major distinguishing factor which has caused the Courts to apply their inherent power of equity. Where the landlord built the improvements on the land and the lessee goes bankrupt, the Courts have not hesitated in upholding a forfeiture. However, where the tenant is largely responsible for the improvements, the Courts have not allowed the landlord to gain

a windfall and have refused the relief on equitable principles.

In examining the cases cited by the Petitioners and decided by other Courts, there is *not* one case wherein the Court allowed a forfeiture of the premises when the lessee was responsible for the improvements.

In the recent case of *In Re Imperial "400" National, Inc.*, 3rd Cir., 429 F 2d 680 (1970), the Third Circuit again reiterated its former position stated in the *Fleetwood* case and held that the appointment of a trustee in reorganization did not constitute a breach of an express covenant in the lease. The Court stated that forfeiture clauses are liberally construed in favor of the bankrupt and the forfeiture clause did not specify the appointment of a trustee in reorganizattion.

The petitioners rely upon the North Carolina decision of *Carson v. Imperial "400" National, Inc.*, 267 N. C. 229, 147 S. E. 2d 898 (1966), which involved the identical corporation and lease as the *Imperial* case decided by the Third Circuit. However, Imperial "400" had sublet the premises to a limited partnership and this limited partnership raised the defense that forfeiture did not apply to them, but only to Imperial who was not in possession. The North Carolina Court held that the forfeiture clause was valid and allowed a forfeiture as to the limited partnership. There are several distinguishing factors between this case and the case at bar:

1) The limited partnership, a sublessee, did not construct the motel.

2) The limited partnership did not request the North Carolina Court to apply its equitable powers.

3) The position of the limited partnership was that the forfeiture provision applied only to the original lessee and not to it as an assignee of the lease now in possession.

4) The Court's decision was solely and strictly founded on the principle that the assignee was bound by the provisions of the lease.

5) The lease before the North Carolina Court was one of many held by the Debtor and forfeiture would not preclude a reorganization.

It is respectfully submitted that the North Carolina Supreme Court would have denied the relief requested had it been asked to apply its equitable powers and been shown an unconscionable forfeiture and a windfall to the landlords of $1,000,000.00 as in the case at bar. The North Carolina Supreme Court, in the case of *Morris v. Austraw*, 269 N. C. 218, 152 S. E. 2d 155 (1969) seven months following its decision in the *Carson* case, quoting from 32 Am. Jur., *Landlord and Tenant*, Section 848, stated:

> ". . . As has been said, the right to declare a forfeiture of a lease must be distinctly reserved; the proof of the happening of the event on which the right is to be exercised must be clear; the party entitled to do so must exercise his right promptly; and the *result of enforcing the forfeiture must not be unconscionable.*" (Emphasis added)

The United States Court of Appeals for the Fourth Circuit refused to allow a forfeiture in the case at bar based upon the rationale of the *Smith* and *Fleetwood* decisions where as here a forfeiture would be the complete emasculation of the reorganization because the entire res would be removed from the estate of the Debtor.

Conclusion

It is respectfully submitted that Petition for Writ of Certiorari should not be granted and as Judge Bryan, in denying the petition for rehearing, so aptly stated:

"(T)he Landlord's insistence upon a forfeiture was highly unconsionable and inequitable in the circumstances—a demand for blood."

Respectfully submitted,

William R. Winders
Winders, Williams & Darsie
Attorneys at Law
First Federal Building
Durham, North Carolina 27701
Attorney for Trustee, Respondent

Allston J. Stubbs
Stubbs, Biggs & Cole
Attorneys at Law
Home Savings & Loan Building
Durham, North Carolina 27702
Attorney for Debtor Corporation, Respondent

Certificate of Service

THIS IS TO CERTIFY that I have this date served two (2) copies of the foregoing Brief in Opposition to Petition for Writ of Certiorari on the attorney of record listed by mailing same to him by United States Mail, postage prepaid, to his office address, as follows:

Mr. Charles B. Nye, Nye & Mitchell, Post Office Box 1131, Durham, North Carolina 27702.

This the 15 day of August, 1972.

William R. Winders
Winders, Williams & Darsie
First Federal Building
Durham, North Carolina 27701
Attorney for Trustee, Respondent